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For Review

THE AUSTRALIAN ECONOMY

# THE AUSTRALIAN ECONOMY

SIMPLE ECONOMIC STUDIES

By

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## PREFACE

DURING August, September and October of last year, I contributed to the *Argus*, Melbourne, and the *Sydney Morning Herald*, a series of twelve articles under the title "Papers for the Times—Simple Economic Studies."

From time to time, since their publication, I have received requests that these articles should be brought together in a small book. With the permission of the editors of the two journals in which they originally appeared, they are here reprinted, together with an article on "The Position of the Farmer," that appeared in both papers on 6 March last. It has been necessary to bring up to date certain figures used in two of those articles and to indicate that much of the general scheme suggested in another has now been completed. Otherwise the articles are practically as they appeared in the above journals.

Owing to the growth of Government deficits and the increasing degree to which they have been financed in recent months by the issue of treasury bills, there is a danger that credit will

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be expanded beyond the requirements of the situation, and that uncontrollable inflation will follow. The importance of this problem has led me to include in the book an article on "Government Finance and Inflation," part of which originally appeared in the *Argus* and was reprinted together with the remainder, as the Bank of New South Wales Circular for 19 December, 1930. I am indebted to the General Manager of the bank for permission to reprint this circular. Owing to the increase in the floating debt and to certain changes in the data on public finance published by the Commonwealth Statistician, slight amendments have been made in it.

This book is published in the belief that it will provide students of the Australian problem (and they should embrace the whole population at the present time) with the main facts and the elementary arguments for an understanding of the causes of the present depression. It also contains an explanation of how inflation develops through the piling up of government deficits. The book may, therefore, assist in educating governments and public opinion upon the urgent necessity for the strictest economy in expenditure, and the development of a plan that will lead to budget equilibrium in the not distant future. With the experiences of so many European countries before us, we should regard this pro-

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blem as a major issue at the moment. To quote a resolution from the International Financial Conference held at Brussels in 1920: "The country which accepts the policy of budget deficits is treading the slippery path which leads to general ruin; to escape from that path no sacrifice is too great."

In collaboration with Professor Shann, I recently published *The Crisis in Australian Finance, 1929-1931* (Angus & Robertson). Readers are referred to that work for further information upon the problems discussed in this little book.

I am greatly indebted to Professor Shann for encouraging me to collect these papers for republication and for assistance in revising the material and in reading proofs. -

D. B. COPLAND.

*University of Melbourne,*  
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15 April,

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## I. NATIONAL INCOME

THE starting-point in economic discussion must be the national income. It tells us how successfully we are using our natural resources, and it sets the limit to our standard of living. For a short period we may raise the standard of living by drawing upon oversea loans. Unless the loans are spent upon productive assets which leave a surplus income to the nation after meeting all charges we cannot maintain the higher standard of living. The ultimate source of private incomes is the amount of the national income. With a given population no permanent rise in average incomes is possible unless the value of goods and services produced has increased. This value is dependent upon (a) the amount of goods produced and services rendered; and (b) the prices at which these goods and services are sold. We may sustain the volume of goods and services, and, owing to a decline in prices, experience a fall in the monetary value of the income. On the other hand, a rise in prices may increase the value of income without any change in the quantity of

goods and services. These disturbing effects of changing prices will be considered after we have examined the nature of the national income.

### PRODUCTION CLASSIFIED

We commence with the year 1926-27, because in that year we have a careful estimate of the distribution of the national income among groups of industries. From investigations that have been made by Australian economists we know that the total income in that year was about £600,000,000, approximately £100 a head of population. That income was produced by three groups of industries—export, sheltered, and protected. The classification is not simple, because some exporting industries, notably sugar and butter, are also protected. We have to classify them as protected. They are able to charge an Australian price for domestic consumption, and they are not open to all the rigours of price changes in the world's markets for their products. Most protected industries, however, sell their products in the domestic market, and they are exposed to competition from imports only after the import duty has been paid. Export industries are those which sell their goods in the world's markets, and are not assisted in Australia by a protective tariff. Wool and wheat are important examples of these. Between these two groups are the

sheltered industries. By their nature they are not exposed to foreign competition, because the services they render cannot be transferred from one country to another. Rail and motor transport, education, the administration of government, and the services of a secretary to a chamber of commerce or a trade union are examples.

The production of the export and protected industries can be estimated. The balance will be sheltered industry. In 1926-27 the distribution was as follows:—

Export industries	.. ..	£150,000,000
Protected industries	.. ..	£150,000,000
Sheltered industries	.. ..	£300,000,000

These figures were worked out by the committee of economists who reported upon the Australian tariff in 1929. The details are in their report. There would not be an appreciable change in subsequent years provided that no violent fluctuations in prices were recorded. We may therefore assume that, roughly, one-fourth of the national income was produced from export industries, another fourth from protected industries, and half from sheltered industries. A serious disturbance of the price level for exports would upset this distribution. That is precisely what has happened during the last twelve months.

## INTERDEPENDENCE OF INDUSTRIES

The three groups of industries are mutually dependent. A failure of any one group to supply its accustomed quota of income will diminish the prosperity of the others. Anything which enhances the prosperity of one group will normally react beneficially upon the other two groups. An increase of efficiency in protected or sheltered production will reduce the costs of export production. The effects of reduced costs in any group are indeed cumulative. Costs in other groups are reduced, and this makes possible lower costs in the group in which the original reduction took place. The lower costs may be brought about by improved efficiency in management, the increased use of machinery, or the fall in the price of imported raw materials. Or again there may be a reduction in the cost of living, followed by an adjustment of wages that would lower costs.

But the most striking cause of rapid changes in the prosperity of any group of industries arises from fluctuations in prices, and the export industries are very much exposed to such changes. For some years until 1928-29 Australia enjoyed favourable export prices, especially for wool. That enhanced the prosperity of export industries, and their increased purchases from sheltered and protected industries spread the benefits to

these groups. Thus we had a basis for rising wages and a generally higher standard of living. The borrowing of some £30,000,000 a year overseas added to the gaiety of economic life, and while the high prices and the borrowing lasted we experienced an era of prosperity.

It would, however, be a mistake to assume that we wasted our higher income in extravagance. There was, indeed, a good deal of non-productive expenditure, both public and private. All classes of the community spent too freely. But with this higher spending there was also an increase in efficiency in many industries. We grow more wheat per acre and we carry more sheep to the acre than we did ten years ago. Some of our secondary industries have lowered their labour costs despite rising wages, and in sheltered industries, like transport, we are getting better services. But the prosperity induced by higher prices and overseas borrowing provided a basis for much wasteful expenditure. We have now to retrace our steps. Borrowing has become almost impossible, and we have suffered a serious loss in the decline of export prices. The volume of production in the export industries has not declined. It has been revalued by the fall in prices. Last year we had less than £100,000,000 for exports compared with £145,000,000 under normal conditions before the slump in prices. This fall in income in export

industries imperils the prosperity of protected and sheltered industries, upsets the balance between imports and exports, and lowers the value of the national income as a whole.

In subsequent articles will be considered the economic effects of this fall in income.

## II. THE BALANCE OF PAYMENTS

**MONEY** is a medium of exchange. A producer sells his products for money in order to purchase the goods and services he requires for his standard of living or the maintenance of his industry. Money is only the intermediary through which the exchange of goods against goods is arranged. The farmer, for instance, sells his wheat for money, and from the proceeds he makes what payments are necessary for the goods and services he requires. Any surplus may be invested or kept, as a balance, at the bank. A deficit may be met by an overdraft. His total payments must be equal to his receipts, if we include in the payments any investments made, and in the receipts any loans obtained. We may look upon the payments and the receipts as the farmer's balance of payments.

### DEBITS AND CREDITS

This simple example may be applied to the transactions of a country as a whole. When viewed in this way the problem of international

exchange is reduced to simple terms. Australia has payments to make abroad, and these payments must be met from the proceeds of what she sells abroad, or receives from loans raised or from other sources of oversea income. The payments are the debit items in the balance of payments: the receipts are credits, and there must be a true balance between debits and credits. A good deal of confusion is caused by discussing the balance of trade, when attention should be concentrated upon the more comprehensive balance of payments. The balance of trade refers exclusively to the relation between imports and exports. But this relation is in part determined by the other items that enter into the balance of payments. Thus, if we are borrowing heavily from abroad, or if foreign capital is being invested in Australian industry, we may be able to continue for a long time with an excess of imports over exports (an unfavourable balance of trade). The heavy imports are made possible, and indeed are a natural corollary of the oversea borrowing.

We should therefore consider the balance of trade always in relation to the balance of payments. In the latter the chief credits are exports, public loans raised abroad, private capital from overseas invested in Australia, the expenditure of visitors to Australia, and the interest received



by Australians upon capital they have invested abroad. On the debit side are imports, interest and sinking fund on the public external debt, interest on private capital invested in Australia, and the expenditure of Australian tourists abroad. There are other minor items, and we have no accurate knowledge of the amount of some of the items mentioned. By far the most important are imports and debt obligations on the debit side of the balance, and exports and oversea loans on the credit side, and we know the value of these items.

#### THE BALANCE OF 1929-30

We may now examine the nature of the balance of payments in recent years. Taking the chief items, the imports and exports for the two years ended 30 June, 1929, were nearly equal at about £145,000,000; and the public loans raised abroad were also approximately equal to the annual obligations on the external debt. Hence the receipts balanced the payments. The receipts increase our London funds, and the payments are made from these funds. As long as receipts are equal to payments there is no scarcity of funds in London. In recent years the supply of London funds depended upon the value of Australian exports and the loans raised abroad. Both these fell substantially in the year ended 30 June, 1930.

The chief items in the balance of payments for this year may be stated as follows:—

DEBITS	
Imports .. .. .	£131,000,000
Debt services .. .. .	£36,000,000
	£167,000,000
CREDITS	
Exports of goods .. .. .	£97,000,000
Exports of gold .. .. .	£28,000,000
Loans in London .. .. .	£15,000,000
Deficit .. .. .	£27,000,000
	£167,000,000

This is a very rough approximation: all minor items are omitted. Such items would only increase the "deficit." The loans include two issues of Treasury bills of £5,000,000 each, and loans raised for the cities of Sydney and Brisbane. The deficit really represents the amount of short-term borrowing that has been necessary for meeting the payments on the debit side. Two main items are involved: (a) the funds belonging to foreigners but retained in Australia on account of the high exchange rate, and invested temporarily in Australian securities; and (b) the overdrafts we have obtained in London.

## PROSPECTS FOR 1930-31

We adjusted our balance of payments in 1929-30 by three expedients—exports of gold, overdrafts in London, and the retention of some funds in Australia. These expedients are not available except to a minor degree this year. We may wipe out our deficit by raising a long-term loan in London, but for the current account we can expect no assistance from loans, and very little from the other special measures that we used last year. London funds will be built up mainly from exports. A good wheat harvest will increase our exports, but with present prices for wool and wheat we cannot expect to make up more than a small amount of the £45,000,000 decline in the value of exports recorded last year.\*

It would be rash at this stage to state a figure; but for purposes of illustration let us take £100,000,000. From this sum the Government must have £36,000,000 for its overseas debt obligations. A margin of £64,000,000 will then be left for imports. This is a decline of £67,000,000

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\* For the first eight months of the year 1930-31 exports of goods amounted to £69,000,000 and gold £7,000,000. But the goods are valued at Australian prices including exchange. Despite many wheat and butter exports the sterling value of goods exported is not likely to reach £90,000,000. Imports for the eight months fell to £47,000,000 and for the whole year may reach only £85,000,000. But this is abnormally low. If they are only £70,000,000 in future and export prices do not improve the excess of exports over imports would be only £20,000,000; and £36,000,000 are required. Gold supplies apart from annual production of less than £2,000,000 will not be available. It will therefore be necessary to expand exports unless Australia can renew borrowing overseas.

on the figure for 1929-30, and £80,000,000 on that for the previous two years. We have therefore to face a reduction in imports unprecedented in the history of the Commonwealth. The reduction will be greater if the present volume of exports is not maintained: it will, of course, be less if we can increase exports. The conditions in the export industries thus have a vital bearing on the balance of payments, and will be examined below.

### III. THE CONDITIONS OF EXPORT PRODUCTION

WHATEVER views may be held concerning economic policy in the depression, no one questions the desirability of maintaining exports at their present volume. The less favourable harvest of 1929-30 reduced the volume of wheat exports. Other exports did not seriously decline in volume. Yet we suffered a great loss in the income we received for our exports. This is clear from the following figures showing the decline in the value of exports for the year 1929-30, compared with the previous year:—

Wool .. .. .	£25,000,000
Hides and skins .. .. .	2,698,000
Wheat .. .. .	10,300,000
Flour .. .. .	1,032,000
Sugar .. .. .	3,006,000
Butter .. .. .	848,000
	<hr/>
Total .. .. .	£42,884,000

#### LOSSES IN EXPORT PRODUCTION

There is a loss here of £43,000,000 (approximately thirty per cent) of what was considered the normal value of exports. We may expect an in-

crease in the volume of wheat exported this year, but in no other exports can we anticipate an immediate expansion. With present tendencies in world prices we must face a permanently lower value for our exports. This means less income for the export industries. If the fall in income was a small amount, the position could be met with minor adjustments of costs. But even with some recovery in prices the loss will be twenty-five per cent this year. No industry can meet a loss of thirty per cent in one year, twenty-five per cent in the next, and perhaps a similar loss in the following years unless it secures a great fall in costs. The alternative is a severe contraction of production to those producers who have the lowest costs of production. This is the prospect facing the primary producers of Australia.

#### THE MARGINAL PRODUCER

In no industry is there a uniform cost of production. The primary industries are spread over lands of widely varying fertility and climatic conditions. There are also considerable differences in the skill with which producers manage their properties. There are always marginal producers. These are the men who can barely make ends meet. The value of their land is just sufficient to defray the costs of clearing, fencing, and generally bringing it to the productive stage.

There is no unimproved land value for such producers. A fall in the prices of their products will destroy the return on their outlay, and perhaps leave them with less than the basic wage.

The point may be illustrated by reference to the wheat farmers of the Northern Mallee in Victoria. Professor S. M. Wadham, of the University of Melbourne, has made a careful estimate of the cost of production of wheat in this area (see his pamphlet *The Boundaries of Arable Cultivation in Victoria*, published by the Melbourne University Press). With wheat at 3s. 6d. per bushel, the income to the farmer would be £113, an enterprise, remarks Professor Wadham, that is "not worthy of consideration." We cannot expect men to devote the best years of their lives to producing wheat under such conditions.

The same reasoning could be applied to other primary industries. There are marginal wool, butter, sugar, and fruit producers. If present prices and present costs are maintained many of them will be driven off the land. A reduction in land values can offer them no relief, for it means that they forgo the fruits of years of labour, and even then earn incomes far below the average for the whole country. It takes time for the full effect of a fall in prices to work its havoc upon the marginal producer. But slowly here and there

farms may go out of production and the volume of exports steadily decline. This is a prospect that must be faced in the process of economic readjustment that now confronts Australia.

### LOWERING COSTS

An essential condition of recovery from the present depression is the restoration of a measure of prosperity in primary production. Some steps have been taken in this direction already. Rural wages in Queensland and New South Wales have been decontrolled, and there have been substantial reductions in some wage rates in the pastoral industry. This will offer some relief, but we cannot expect the workers and the producers in primary industries to bear the whole of the burden of the loss of income. The farmer must buy the products of other industries, he must use transport and pay taxes for the maintenance of government, and he must meet his interest obligations. A reduction in any one of these costs will not meet the deficiency in his income caused by the fall in prices. Only by a sharing of the losses can the position be met. Land values and interest payments are considered below.

### THE BURDENS OF THE TARIFF

Let us look for a moment at other costs. Under Australian conditions of protected and sheltered



production the farmer pays higher prices for the goods and services he requires for the maintenance of his industry. Part of these high prices is due to the tariff. An exhaustive inquiry carried out by a committee of Australian economists found that, after allowing for all assistance the export producer receives, the net burden of the tariff on him amounted to eight per cent of his costs. The tariff has been greatly increased in the past three years, and the value of export production has declined. The tariff costs on the export producer will therefore have increased. A higher tariff ultimately adds to the burdens of the export producer, unless it is accompanied by a lowering of costs in protected industries. A sheltered industry like transport also experiences increased costs, and will endeavour to pass on these higher costs.

Misdirected economic policy may therefore impose a severe burden on export producers. The same comment applies to wage rates that are higher than the productive capacity of industry will permit. To meet the position created in the export industries, it is essential that costs in protected and sheltered industries should be reduced. Unless this is done the marginal producer will sooner or later succumb to the inevitable economic pressure of accumulated losses, and exports will decline.

## LAND VALUES

But even allowing for the relief offered by lower costs in other industries and lower wages in export industries, there still remains the burden of land values. In industrial enterprises the decline in share prices spreads the capital losses of a depression over a large body of shareholders. There are also capital losses in primary production. Land has been valued on the basis of favourable prices. The investor takes the risk of a fall in prices, and therefore a fall in the value of his security. The producer also assumes a risk when he devotes his capital to the purchase of a farm. Many recent purchasers will lose this capital, and may be even unable to meet the full interest on their mortgages.

This is a difficulty familiar in all primary producing countries. It is met by a slow scaling down of mortgages, and this process has now commenced in Australia. As with other costs, a reduction in interest payments may be an essential condition of the maintenance of some primary producers. It is vital for the economic prosperity of Australia that primary production should not decrease, and an equitable lowering of costs is the only method by which the position can be met.

#### IV. THE CONDITIONS OF PROTECTED PRODUCTION

LIKE export production, the protected industries come into competition with overseas producers. They must meet the competition by selling at a price below the cost of importing similar goods from overseas competitors.

But there are two vital differences between the export and the protected industries. In the first place, exported goods must meet competition in the overseas market after paying the cost of transport from Australia. The protected industries for the most part sell their products in the domestic market, and have the advantage that overseas competitors must meet the cost of transport to Australia. In the second place, a substantial duty is placed upon the goods of overseas competitors, and the protected industries in Australia are able to charge higher prices by reason of the protection afforded them through the duties on imports and the cost of transport. Export industries for the most part get no tariff assistance, though they receive other assistance, and the cost of overseas transport de-

presses the Australian price of their goods. There is thus a natural (transport) as well as an artificial (tariff) disparity between the conditions under which export and protected industries are developed.

#### EXCESS COSTS OF PROTECTION

Taking the estimates made by the Tariff Committee for 1926-27, the amount of protected production was as follows:—

Primary industries .. .. .	£40,000,000
Secondary industries .. .. .	£110,000,000
	<hr/>
	£150,000,000

The primary industries include butter, sugar, and dried fruit. Each of these has a special Australian price by which it defrays the losses on exports. The tariff makes possible this special price, and it is a burden upon Australian consumers. Moreover, it enters into the cost of living, and, under Australian practice, raises money wages. This, in turn, adds to the cost of production in all industries, including the protected industries themselves.

In the secondary industries that receive protection there is also a special Australian price. It varies according to the efficiency of the industry, and was estimated by the Tariff Committee to be on the average about twenty-four per cent

above the price of the same goods imported duty free. This also is an added burden upon Australian consumers, and increases the costs of production of industry generally. The total excess costs for all protected industries in 1926-27 was estimated at £36,000,000, or twenty-four per cent of the total income derived from these industries. This was the approximate cost of the tariff to Australia for that year.

#### THE TARIFF AND PRICES

We have seen that the export industries have suffered a severe loss of income through the fall in oversea prices. How are the protected industries affected by the fall in world prices? Every decline in prices abroad will increase the severity of the competition of oversea goods with protected goods in the Australian market. But the fall in prices of secondary products overseas has been much less than the fall in prices of such goods as wool and wheat. Hence, protected production in Australia has not been so adversely affected by the general decline in the price level. The pronounced rise in the tariff since November (1929) has, moreover, given protected production an additional shelter against oversea competition. Had higher import duties not been imposed, protected production would have felt more of the shock of the world depression in prices. The

tariff has given it a privileged position, and has thus helped to sustain a high Australian price level, because sheltered industries, such as transport, are able, within wide limits, to keep up their prices, and they endeavour to pass on the portion of the excess costs of protected goods that falls upon them. Hence high costs in the protected industries help to sustain high prices in the sheltered industries, and thus to inflate the general price level.

#### WHY COSTS MUST FALL

But neither protected nor sheltered industries can escape the losses of economic depression. The decline in the national income forces a contraction of demand for all classes of goods, and a fall in imports must not be regarded as automatically leaving a larger market for protected goods in Australia. Such an assumption is implicit in the views of those who advocate a prohibitive tariff as a means of promoting Australian industry. In recent months we have raised the tariff and imports have also declined heavily. There has also been a large and growing volume of unemployment in the protected industries. The cause of this unemployment is to be found in high costs of production and the decline in spending power. It is not suggested that protected industries as a whole are inefficient, or that costs in these in-

dustries are not lower than they were a year ago. As with export industries every effort is being made to get costs down. That they are too high may be shown by the following comparison of prices as at February, 1930, collected by the Royal Commission on the Coalmining Industry:—

	Cost per ton.		
	Great Britain.	U.S.A.	Australia.
Pig iron . . . . .	£3 12 0	—	£5 15 6
Steel rails . . . . .	8 10 0	£9 0 0	11 17 6
Wire nails . . . . .	9 17 6	11 4 0	20 11 3
Galvanized iron . . . .	13 2 0	16 6 8	22 10 0
Cement . . . . .	2 7 0	3 0 0	4 2 0
Steel joists . . . . .	8 10 0	9 0 0	11 17 6

### WAGES AND EFFICIENCY

With such a disparity in prices of Australian and oversea goods it is impossible for local industries to expand sufficiently to absorb the unemployed workers, and thus to make up the deficiency in national income caused by the fall in export prices. Prices cannot be sufficiently reduced by a fall in wages, though such a fall is inevitable under existing conditions. The point may be illustrated by reference to the wages paid in manufacturing industries in Australia. For the year 1927-28 total wages amounted to £91,365,000, the value added (net income from these industries) was £167,403,000, and the total value of output

including the costs of raw materials and fuel used was £417,000,000.

A fall in wages cannot therefore bring all the relief required. There must also be an increase in general efficiency. For this purpose the economies of large scale production are necessary. There has been some tendency to increase the size of the factory in recent years. Thus the proportion of total factory workers employed in factories with more than 100 hands rose from 35.7 per cent in 1907 to 43.7 per cent in 1926-27. A further development in this direction is an essential condition of a fall in costs in all secondary production, and this fall must take place before Australia can solve her unemployment problem.



## V. THE LOSSES OF DEPRESSION

It has been shown above that Australia has incurred a serious loss of income. There is always a fall in national income during a depression. It manifests itself in all countries in a decline in profits and an increase in unemployment. If the depression is not severe prosperity may be restored without fundamental adjustments. Australia in common with the rest of the world experienced such a depression in 1908 and again in 1921. In both cases a rise in the prices of exports followed soon after the depression, and our traditional policy of oversea borrowing was not seriously interrupted.

It cannot be too often repeated that the depression of to-day differs from those of recent history in two important respects. Firstly, the fall in export prices has been much more pronounced, and there is no prospect of a complete recovery in prices. Secondly, we cannot obtain further loans from overseas. The loss of income is thus much greater on this occasion, and it is also more enduring.

## MONEY LOSSES AND REAL LOSSES

It is first necessary to distinguish real losses from money losses. The distinction may be illustrated in the following way. Under the conditions operating up to 30 June, 1929, we could expect exports to reach £145,000,000. If the price level in Australia fell twenty per cent we could incur a reduction in exports of twenty per cent, that is, £29,000,000, without suffering a real loss in the income received from exports. With lower prices and lower money incomes there would be no fall in the standard of living. The volume of the national income would not be reduced; its money value only would have been adjusted by the general fall in the price level. Unfortunately, the price level throughout the world is subject to considerable fluctuations, sometimes rising and sometimes falling. When prices are falling most people measure their losses in money values disregarding the fact that money will purchase more at the lower price level. The real loss is much less than the money loss.

Australia is in this position to-day. Our price level is falling, and the more it moves towards the lower level of world prices the greater will be the decline in money income, and the less the loss of real income. There are two reasons for this. First, the exporting industries will be able

to secure a substantial reduction in costs to enable them to continue production at the lower level of prices in the world market. The volume of exports would not then be greatly reduced. Secondly, lower costs would also prevail in protected industries, which would then compete more effectively with imports and be in a position to absorb some of the unemployed and expand their output. There might then be not merely a restoration of the former volume of protected production, but an actual increase that would afford some compensation for the loss of income in the exporting industries. If, however, protected industries use the recent increases in the tariff to sustain high prices this satisfactory result cannot be attained.\*

#### THE INCIDENCE OF THE LOSS

Pending such a fall in prices and an expansion of production there is a serious loss of real income. The first incidence of the loss is on the income of export producers, the profits of industry generally and the unemployed. The magnitude of these losses may be indicated. Exports have declined by about one-third, and the incomes of export producers will have fallen accordingly. In

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\* A more detailed statement of the loss of national income will be found in my statement of evidence before the Commonwealth Arbitration Court and reprinted as one of the documents of the economic crisis in Shann and Copland: *The Crisis in Australian Finance, 1929-31* (Angus and Robertson).

recent months the values of shares have fallen by thirty-five per cent to forty per cent on the average. The decline in profits was probably not less severe. Unemployment has rapidly increased, and the official figure for the second quarter of 1930 was a record, at 18.6 per cent.\* Most classes of the community have been affected by these losses though the distribution of loss between and within classes is inequitable.

The reduction in real income has been very substantial, because Australian prices have fallen less than world prices. While this disparity in prices exists, the distribution of the loss of income tends to remain as already indicated. Export producers find no relief from lower costs, industry generally continues with reduced profits, and unemployment increases. The losses thus tend to be cumulative. They pile up, causing serious social and financial disturbance. To meet the difficulty a fall in costs is essential, and this must be accomplished by an all-round increase in efficiency and a fall in salaries and wages. Both adjustments are now in progress, but they must be expedited if the losses of income are to be kept within reasonable limits. It is frequently asserted that a fall in wages reduces the spending power of the people and aggravates the situation. This is

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\* By the fourth quarter of 1930 unemployment had risen to 23% and the values of industrial shares had fallen by 50%.

surely a fallacy. The loss of spending power has already been incurred. It will become greater if costs are not reduced to enable more goods at lower prices to be produced.

### THE RATE OF INTEREST

But it is argued that, while prices and incomes are falling, the rate of interest has not fallen. This is quite true at the moment, and it is always a disturbing fact in a period of depression. It is equally true that in prosperous times when prices are rising, the rate of interest lags behind. Those who receive incomes from mortgages, debentures, or Government stock incur a loss of real income during rising prices. They are the only people to escape a loss in the first stages of a depression. But they don't maintain their privileged position for long, and, in any case, it must be remembered that they are not a social class distinct from other classes. In the first stages of depression industry is heavily over-capitalized with short-term debts, mainly in the form of overdrafts. Capital is scarce and interest rates are high. As readjustment proceeds these short-term debts are reduced, bank advances are decreased, and more saving is possible. Interest rates then fall.

In confirmation of this it is only necessary to draw attention to the fall in interest rates on the

short loan money markets in London and New York in recent months. Australia has had good reason to be pleased with this movement. Within the last fortnight (August, 1930) she was able to renew £5,000,000 in Treasury bills in London at a rate of interest of less than £3 2s. per cent. A year ago the rate was £6 11s. per cent. While we cannot expect such a spectacular fall in rates of interest on long-term loans, there is no doubt that a decline will occur as prices fall and economic readjustment proceeds. Many mortgagees will doubtless find it necessary to reduce their rates, because primary producers will not be able to meet their obligations. With regard to Government stocks, the declines will occur in the process of conversion as the stocks fall due. But the decline in the rate of interest cannot take place while industry is carrying a large amount of floating debt and capital is scarce.

## VI. CREDIT AND THE BANKING STRUCTURE

THE vital test of the soundness of a banking structure lies in the nature of the assets of the banks. In all businesses it is, of course, true that the relation of assets to liabilities is the test of solvency. Banking is, however, a special type of business, in which the proportion of liquid assets must be high. Advances constitute the principal assets of the banks, and it is through advances that banks furnish credit to industry. The banks themselves collect funds in the form of deposits, and make these funds available to industry. It is sometimes stated that the banks can create credit by the simple process of issuing advances to producers, and this view has led to some misunderstanding concerning the nature of banking. To a certain extent banks do create credit, but their powers in this matter are limited. Firstly, they must keep sufficient cash reserves to meet the demands of trade, and, secondly, their advances must be made against productive assets. With regard to the first, an increase in advances tends

to increase the spending power of the community, and unless it is followed by a corresponding increase in production prices will rise.

Such an increase in prices is inevitable if credit is expanded beyond the real requirements of productive industry. In other words, inflation may be caused by an excessive issue of credit. With higher prices, there is an increased demand for cash, and the bankers find their proportion of cash to deposits declining. There may, however, be considerable variations in this proportion, and to this extent banks are able to create additional credit. But if the credit created leads to a depletion of cash reserves it is then necessary to reverse the policy by reducing advances, lowering prices, and, therefore, the demand for cash, and thus replenishing cash reserves. If this is not done prices will remain high and ultimately cause exchange difficulties, unless prices in the outside world are rising.

This extension of advances has been taking place in the Australian banks in recent years, and the proportion of cash to deposits has fallen to a little more than fourteen per cent.\* With the development of the Commonwealth Bank as a cen-

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\* Under the influence of central bank policy in financing government deficits the cash reserves (notes and cash with the Commonwealth Bank) have increased in the March quarter of 1931 to about 23%. The cause of this movement is explained in Section XIII below. Bank advances however remain in excess of deposits, partly because deposits have fallen slightly and partly because advances have been sustained at a high level.



tral bank and the withdrawal of the gold from the private banks, there has been a steady decline in this proportion of cash to deposits, but the banks doubtless feel that the present proportion is unduly low, and this is one reason why it has been found necessary to restrict credit in recent months.

#### RELATION OF ADVANCES TO DEPOSITS

The second test of sound policy of making advances lies in the degree to which such advances are accompanied by a corresponding increase in production. If advances are accompanied by a corresponding increase in deposits, it may be assumed that production is developing satisfactorily, and industry is making available increasing deposits to sustain the policy of the banks. If this is not the case, the advances of the banks become less liquid, because they are not always being made against productive assets, and this development is a breach of sound banking practice. It is unfortunately necessary for the banks to make such advances during a period of depression, and this has been done in the past twelve months by the Australian banks. The advances show an increase from £248,000,000 at 30 June, 1929, to £263,000,000 at 30 June, 1930. At the same time, total deposits declined from £286,000,000 to £268,000,000. The ratio of ad-

vances and discounts to deposits rose from 86.7 per cent to ninety-eight per cent. This indicates that the banks were making available credits to industries that had been adversely affected by the depression.

Such a condition of affairs cannot, of course, continue indefinitely without unduly increasing the proportion of non-liquid assets held by the banks and, therefore, compromising the credit structure for which the banks are responsible. Given a policy of deflation and a return to exchange parity with London, the banks have no alternative but to attempt to reduce their advances. Banks have also been holding considerable quantities of Government securities, and if the proportion of advances and Government securities to deposits is taken, it will be found that it has moved from 94.7 per cent in June, 1929, to 104.9 per cent a year later. Here we have an excess of advances and securities over liabilities. This is made possible by reason of the fact that the banks had accumulated reserves during the prosperous period before the depression.

#### A CENTRAL BANK

The prosperity of a country may be considerably influenced by the policy pursued by bankers, and it is for this reason that nearly all countries

have found it necessary to establish central banks. The tendency to increase credit unduly in periods of good trade is sometimes irresistible. This may lead to an over-extension of credit, which promotes economic prosperity for the time being. When, however, it is found that the proportion of cash reserves to deposits has fallen and the proportion of advances to deposits has risen, banks find it necessary to reverse their policy, and this is a contributing factor to economic depression. Such developments may occur even under ordinary conditions when there has been no serious decline in export prices. It is the purpose of a central bank working in co-operation with the other banks to avoid an undue extension of credit, and thus to render unnecessary a policy of credit restriction. Hence the problem before a central bank is to promote stability of business conditions.

It is not suggested that complete stability can be secured even by the most successful central banking system, but the banks under a co-ordinated and far-sighted policy can do much to promote business stability. For this purpose it is necessary that the central bank shall have the confidence of the other banks, and shall be working in close co-operation with them. In Australia efforts have been made in recent years to develop the Commonwealth Bank into a central bank, and

much has been achieved in this direction. Towards this end the bank has not pursued an active trading policy; the Savings Bank has been separated from the general banking department; the bank has control of the note issue; many of the commercial banks now keep substantial reserves with the Commonwealth Bank; before the present depression it had substantial funds in London; and, finally, it has built up a large proportion (sixty per cent at the end of 1929) of liquid assets.\* These conditions are essential for the development of successful central banking. If a new central bank were established in Australia it would be necessary to build up a similar organization, and this would take a considerable time. Such a central bank would be of little value in the present crisis. For the Commonwealth Bank to complete its evolution towards a central bank, it must build up a technique of "open market dealings" in public securities, whereby it can make its policy effective. For instance, if it were desired to stimulate business at any time, lower rates of interest might be promoted by the purchase of Government securities by the Central Bank. This would also have the effect of in-

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\* The liquidity of the assets of the Commonwealth Bank is greatly affected by the soundness of Government securities as an investment. Since 1929 these securities have fallen in price and they are to some extent frozen assets. Sound finance and confidence in a Government are essential to the functioning of the Bank as a central institution.

creasing credit, and enabling the commercial banks to proceed with a more ambitious policy in granting advances. Conversely, the sale of Government securities would increase interest rates and cause a restriction of credit. Such dealings in securities are undertaken by central banks abroad for the purpose of securing co-ordination of banking policy.

## VII. CONTROLLING EXCHANGE

IN paying interest on an external debt a country must collect the necessary funds from its people by taxation, and "transfer" these funds to the holders of its securities abroad. These two problems have engaged the attention of many countries since the war because both victors and vanquished had accumulated heavy external debts in a short period. There has been some controversy concerning the relative difficulties of the two problems. Is it easier to raise the necessary taxation in the country than to transfer the funds overseas? The answer to this question depends upon the taxable capacity of the country, the buoyancy of its national income, and the nature of its foreign trade. In a period of depression when the national income has fallen and the export trades are suffering from a decline in world prices, both problems are difficult. This is the situation in which Australia is placed to-day. She has to meet payments on account of her external debt amounting to £36,000,000 annually.

## THE TRANSFER PROBLEM

The taxation problem involved will be examined in a later article. I proceed to discuss what has been called the transfer problem. British holders of Australian securities have to be paid in British currency. They want a cheque on a bank that will entitle them to credit or currency in Great Britain, not in Australia. To fulfil this requirement the Commonwealth Government must have claims to credits in Great Britain against which it (or its agent) can draw the necessary cheques in favour of the British holders of its securities. By raising taxation in Australia the Government can establish the necessary credits here. But a credit in Australia must be transferred into a credit in London before the interest can be paid in Great Britain. This is the transfer problem. In recent years the Australian Government has been able to obtain credits in London, because it was raising loans there. The funds obtained from the loans were paid to the account of the Government in London, and the funds raised in Australia by taxation to meet the interest on the external debt were used for loan expenditure here. It is not true, as is sometimes stated, that we were borrowing merely to pay interest, but the oversea borrowing simplified the transfer problem.

## BANKS AND LONDON CREDITS

This is a simple statement of the position. In fact, the loans did not exactly balance the interest payments. Sometimes they were greater and sometimes less. The adjustment of differences was made through ordinary exchange transactions, which must be examined in discussing the present transfer problem. We have now to meet our external interest payments without oversea borrowing. The Government must therefore find some new source of credits in London. This is available through the Australian banks, but only under certain conditions.

The banks are constantly transferring funds between Australia and Great Britain. All imports and exports involve such transfers. Australian exporters are paid in Australian credit or currency, and the oversea purchaser pays to the account of some bank (or other exchange broker) an equivalent amount in London. Exports thus create Australian credits in London. Imports on the other hand are paid for from these credits. There are other transactions which increase or decrease the supply of our credits in London, but we may ignore these as not being sufficient to affect the argument. We then have Australian exports creating credits in London, and from these credits are paid imports and debt obligations. The banks



finance imports and exports, and they will have credits in London, provided the exports exceed the imports. The Government may then buy these credits by depositing the proceeds of taxation with the banks in Australia. The banks will then supply the Government with the necessary credits in London from which interest can be paid.

### THE EXCHANGE POOL

This is indeed the essence of the arrangement made recently for pooling exchange. The banks will supply £3,000,000 in London credits per month to the Government, which pays for this in Australia at the current rate of exchange. This rate is now £106 10s.\* for a telegraphic transfer of £100 in London. It is less for bills depending on their time of payment. The high rate is, of course, due to a scarcity of credits in London, and the banks are prepared to pay £106 2s. 6d. in Australia to the exporter who has an immediate claim of £100 in London. The high rate thus gives an "exchange bounty" to the exporter, but imposes an additional "duty" on the importer, and increases the amount the Government must pay for its credits in London. The exchange pool is an attempt to control the exchanges at this level and to furnish the necessary

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\* Since this was written the rate has risen, as a result of competition for the credits in London, to £130 10s.

credits in London to enable the Government to meet its overseas obligations. I have examined the detailed conditions necessary for the success of this arrangement in a book on *Credit and Currency Control* recently published. Suffice it to say here that the main condition is an excess of exports over imports of £36,000,000, representing the credits the Government requires in London. We must, therefore, expand our exports or decrease our imports, and this raises questions pertaining to internal economic conditions which have been examined above.

#### COSTS MUST COME DOWN

Costs in the export industries must be reduced to sustain them at the present low prices and allow them to expand. For this purpose costs in protected and sheltered industries must also fall. Such a fall would enable local industry to compete more successfully with imports, and thus to reduce imports. An exchange pool can at best be a piece of financial mechanism for meeting external obligations. Its success depends ultimately upon the efficiency of our industries and their costs of production. Exchange control is in itself no solution. Indeed, if it is not accompanied by the necessary readjustments in internal economic conditions to produce the required surplus of exports it may aggravate the situation

by creating a false sense of security. Thus, efforts to limit imports by tariff prohibition or higher duties may help to sustain a high local price level and discourage the decline in costs required for the maintenance and expansion of exports. In attempting to reduce imports it is necessary, first to safeguard industries that depend upon external supplies of raw materials and semi-manufactured goods, and secondly, to avoid any action that will sustain or increase costs in the export industries.

## VIII. MARKETING AND THE MERCHANT

FOR some years there has been considerable controversy in Australia concerning the relative efficiency of different methods of marketing primary products, notably wheat. The fall in prices has made this controversy more acute, and during this year there has been much agitation in political circles and among wheat producers for a compulsory pool. It is an aspect of the present depression that may have important consequences for the future of primary production in Australia. This is my reason for discussing it here.

### THE COSTS OF MARKETING

We may take wheat as an illustrative case because there has been so much discussion on the marketing of this commodity that the facts are fairly well known. First it is necessary to clear away a misunderstanding that is very common in considering the cost of production of primary products. Marketing is an extension of produc-

tion. The farmer looks with dismay upon the great difference between his price and the price the oversea buyer pays for the wheat in the importing country. The difference is necessary to cover all the costs of transferring the wheat from the farm to the oversea buyer. As production extends to new and more distant lands, and transport by sea and land increases, these intermediate costs become greater. They are frequently confused with the more purely marketing costs; that is, the costs of arranging for the sale of the wheat. In view of this confusion it may be desirable to set out the average cost of handling wheat from the farmer's waggon in Australia to Liverpool in a normal season.

	Pence per bushel
Country agent's commission .. ..	1.500
Overhead, including loss of interest ..	.875
Terminal handling charges, including rentals and wharfage .. .. .	1.125
Inland freight .. .. .	4.50
	<hr/>
Total cost to seaboard .. .. .	8.00
Oversea freight .. .. .	12.50
Insurance and interest on B./L. ..	.50
	<hr/>
	13.00
	<hr/>
Total cost* .. .. .	21.00

\* Since this was written overseas freight charges have fallen and a slight reduction in country agents' commission has been made. The effect is to reduce the total cost to about 19 pence.

These items vary a little among the Australian States, and oversea freight varies from year to year. For last season it was much below the figure mentioned, and though rising at present it is still lower.

#### CONDITIONS OF EFFICIENT MARKETING

Analysing the costs briefly it is noticeable that of a total cost of 1s. 9d. per bushel 1s. 5½d. is payment for inland and oversea freight, and insurance. These are strictly not costs of marketing, and would not vary with a change in the system of marketing. Of the remainder—3½d. per bushel—terminal handling charges account for about 1¼d., leaving 2¼d. for economy in the process of marketing. This has to meet country agents' commission and overhead. Under any system of marketing, charges for these services would have to be met. The wheat has to be received at country stations, and loaded on trucks, and there would also be the overhead charges for any marketing organization. A saving of over 20 per cent on these items would be required to reduce the costs of marketing by ½d. per bushel, and this might fairly be regarded as the maximum saving possible. But it would be realized only (1) if the new marketing organization were generally more efficient and its overhead cost lower, (2) if it was able to handle the wheat at

country stations more economically, and (3) if it adopted as sound a selling policy as prevails at present.

It is with respect to the last mentioned that the real difficulty arises. At present wheat marketing is carried out by private merchants, and voluntary pools in some States. The published records of the average prices received by the farmers under the two systems in recent years shows a balance in favour of the merchants in all States except Western Australia, where the pool showed a net advantage over the whole period, 1924-25 to 1928-29, of slightly less than 1½d. per bushel. In the other States the advantage in favour of the merchants averaged (per State) 10d. per bushel for this period. Clearly the merchants were more efficient in these States. Better returns might have been due to (a) successful chartering of wheat vessels, and (b) a sales organization enabling wheat to be shipped to any market where supplies were required at satisfactory prices. Given the prevailing tendency of prices in the world's markets the return to farmers depends much more upon the success with which this part of the marketing process is accomplished, than upon the small savings possible in handling charges or overhead costs.

## ECONOMICS OF POOLING

The proposals for a compulsory pool must be considered from this aspect. Is the pool likely to be more successful in chartering and in distributing the wheat throughout the world's markets? The Canadian or United States examples cannot throw much light on the matter. In neither case is there a compulsory pool and the problems of management would be different under a compulsory pool. The pool would be controlled by a representative board, and the management would have less initiative than the Canadian pool, and much less than the merchants. The responsibility of the pool would be enormous. There is the risk of great losses from mistakes in selling policy, and in chartering, and also the possibility of gains. But bearing in mind the difficulty of securing sufficient independence of management and the danger of interference by relatively inexperienced representatives on the board, the risk of loss is considerable. Any loss must be shared equally by farmers, just as a gain would be distributed among all.

Marketing is a highly technical function, and there is no guarantee that a compulsory pool would perform it more successfully than the merchants and the voluntary pools to-day. The depression in prices is not due to the present



marketing machinery, but to a general increase in production. Compulsory pooling could not alter this, though it might attempt to raise the local prices, as was done with butter. There is indeed a danger of such a proposal. The local price for wheat, to offer a gain of 6d. per bushel over the whole crop, would have to be raised by between 2s. and 2s. 6d. per bushel, and this would increase the cost of living. Higher wages and rising costs of production would follow and another industry would be placed within the vicious system of artificial control so prevalent in Australian industry.

## IX. THE GENERAL LEVEL OF WAGES

IN common with other new countries Australia has always been a high-wage country. Relative to population productivity has been high, and this has been the basis upon which high wages have been paid. There has, of course, been much controversy about the rate of wages that the country could afford, and trade unions have sought to raise the general level of wages. Partly owing to their efforts the numbers of wage-earners working under the awards of wage-fixing tribunals has steadily increased. This has undoubtedly raised the general level of wages, though it might not have greatly increased the basic wage. Indeed, apart from the addition in 1922 of what is known as the "Powers 3s." there has been no apparent change in the real basic rate. Wages have moved with changes in the cost of living, as measured by an index number of food prices and house rents. This index number has been higher in recent years than an index number which included clothing and other household expenditure, so that the basic wage has been kept

a little higher than if the complete index number had been used. Real wages then have in fact increased since 1907. Besides, more workers are now getting this basic wage, and there has been much regulation of working conditions by industrial tribunals. The result has been an appreciable rise in the general level of real wages.

### THE BASIS OF WAGES

The question now arises: Can the country sustain this general level of wages reached after years of discussion and controversy? No doubt trade union pressure put the general level up in the years of prosperity higher than it would have been without such pressure. That does not mean that high wages are due to the strength of trade unionism. In the United States wages in many industries are higher than in Australia, and there is much less trade union pressure there. Wages in Great Britain have always been higher than in Germany, but the trade unions in Germany are very strong. The most important influence determining the level of wages in any country is not the bargaining power of employers and employed, but the productivity of industry, and the national income per head that can be sustained by this productivity. The general level of wages may be raised by pressure from organized labour, but it cannot go beyond a point fixed by the productivity

of industry. This is the important fact confronting wage-earners in Australia. A general level of wages that was economical in prosperous times becomes too great a burden in adversity.

If this adversity were due to a temporary trade depression a reduction in the standard of living would not be necessary, but the present difficulties of Australia are much more serious. It cannot be too often repeated that we have suffered a loss in national income of 10 per cent, and there is no immediate prospect of this being made good. The indirect effect of the loss, shown clearly in the growing volume of unemployment, means that the reduction in national income is now more than 10 per cent. The indirect losses will, however, be reduced as industry recovers. A continuance of depression inevitably increases the indirect losses, and the vital need of the moment is to face the first loss and thus to provide a basis for economic recovery.

#### WHY WAGES MUST FALL

The bearing of this on the general level of wages may be stated as follows: The export industries are severely depressed by low prices and high costs. They cannot raise their prices, and if they are not to suffer a contraction of output their costs must be reduced. Already the shock from the loss in export production and the ces-

sation of borrowing has seriously reduced the income of other industries, and there is widespread unemployment in both sheltered and protected industries. If the volume of export production falls, as it will unless some reduction in costs is achieved in other industries, there will be more and more unemployment in protected and sheltered industries. We should then continue the present practice of keeping up a high level of wages for a decreasing number of workers while the rest of the wage-earners are unemployed. Already there have been reductions in wages in export industries, and Australia is developing a system of inequalities of income among wage-earners, so pronounced in Great Britain in recent years. Wages in the unsheltered (export) industries are lower than wages in sheltered industries.

Australia has an exceptionally good chance of stopping this tendency, and spreading the sacrifice more evenly. Its wage-fixing tribunals can apply the necessary reduction in real wages to all industries. In doing so, they will reduce costs in protected and sheltered industries, and enable them to reduce their prices and expand their output. Costs in the export industries will then also fall, and a serious crisis in these industries will be averted. It is a great opportunity for Australia to prove to the world that its wage-fixing machin-

ery is capable of meeting a crisis with expedition and equity.\*

#### SACRIFICE AND SPENDING POWER

Two problems may occur to the reader: they will certainly trouble the wage-earner. I can deal with them only very briefly here.

First, it will be said that the wage-earner is bearing the whole burden of the loss of national income. That is not so. Already those engaged in export industries have suffered great losses of both capital and income, salaries have been reduced in many businesses, and the balance-sheets of industrial companies show a serious and increasing fall in profits. There remain only the recipients of fixed incomes, and quite clearly they will be asked to bear their share of the loss in the form of increased income tax and ultimately of lower rates of interest. The reduction of ten per cent in real wages will spread the share of the loss falling upon wage-earners evenly among the whole group. At present the unemployed are bearing the whole of this burden.

Next, there will be a protest that a reduction in wages means a fall in the spending power of the country. That is a fallacy. The fall has already

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\* The order of the Commonwealth Arbitration Court of January 1931 reducing the basic wage by 10% has accomplished a large measure of what was suggested here. It remains for the State tribunals as a whole to follow the lead of the Commonwealth Court.

occurred, and it is proportional to the decline in national income. Anything that increases national income or prevents it from falling further will also raise the spending power of the country or arrest the present decline in spending power. A fall in the general level of wages is necessary if industry is to be restored, and this is the quickest and surest way of increasing spending power.

## X. COSTS OF DEVELOPMENT

PUBLIC finance and economic development are intimately related in Australia. State ownership of railways and other enterprises, and the special measures taken by Governments to settle people on the land and to develop secondary industries have involved much public loan expenditure that is normally left to private enterprise. Australia has gone much further in this direction than most other countries, and our loan expenditure had risen to over £40,000,000 per annum before the present crisis. Sir Lennon Raws made an analysis of the total loan expenditure of the States and the Commonwealth at June 30, 1927, and his figures illustrate the degree to which Governments have been engaged in economic development. His paper was published in the *Economic Record* for November, 1928, and will repay study at the present time. The following were the principal objects upon which loan moneys had been spent:

Railways .. .. .	£311,000,000
Water supply, irrigation .. .. .	115,000,000
Other business undertakings .. .. .	93,000,000



## COSTS OF DEVELOPMENT

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Harbours and rivers .. .. .	39,000,000
Soldier settlement .. .. .	48,000,000
Advances (homes, public bodies and settlers) .. .. .	26,000,000
Development (rural lands) .. .. .	38,000,000
Roads and bridges .. .. .	26,000,000
Public Buildings .. .. .	24,000,000
Miscellaneous .. .. .	18,000,000

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£738,000,000

## THE BURDEN OF UNSOUND EXPENDITURE

Since 1927 the expenditure has been considerably increased and Australia has now a total debt on this account of more than £800,000,000. It is clear that a debt of this magnitude will greatly compromise budgets if it is not backed by interest-earning assets. Sir Lennon Raws found that in 1927 the net deficit on all business undertakings of Australian Governments amounted to £6,200,000, or over 1½ per cent on the capital outlay. The position is worse now, because the State enterprises have been adversely affected by economic depression. But it was unsound before the depression, and our public loan expenditure for economic development was indeed the source of growing budget deficits. In many cases the costs of development had been greater than the earnings of the enterprises justified: in other cases the charges for the services were not sufficient to meet the costs. In few cases were the

rigid methods of private finance adopted, and most enterprises were a charge on the public revenue. If a surplus was earned it was paid into consolidated revenue.

In this way the interest burden of the public debt became a menace to all State budgets. The average rate of interest on the States' debts rose from £4 14s. 4d. per cent in 1924 to £4 18s. 4d. per cent in 1929, and owing to the rapid extension of State enterprises in this period there was an increasing proportion of unprofitable expenditure. An example, perhaps an extreme case, may be instanced under the group settlement schemes. In Western Australia it has cost about £3300 to bring each farm to a productive condition. A board is now revaluing the farms, and the average capital upon which settlers may be expected to pay interest is £1100. This does not provide for roads, railways, drainage, or stock and plant advances. Other States also have examples of developmental projects which have not justified the capital expenditure.

#### THE TEST OF PROFITABLENESS

It was this fact that led the British Economic Mission to express the view that Australia had mortgaged the future to an undue extent. The reports of the Development and Migration Com-

mission provided ample evidence that insufficient care was being exercised in the expenditure of loan moneys. Charged with the duty of approving projects for the expenditure of £34,000,000 under the Migration Agreement with the British Government, the Commission after nearly three years of investigation had been able to recommend schemes to the extent of only £5,000,000. In its annual report for 1928 the Commission remarked that the soundness of the schemes was the dominant consideration. The test was not only that the expenditure would yield an indirect and remote advantage, but that within a reasonable time the results would be directly profitable to the tax-payer and the people, including the migrant.

When developmental expenditure is launched without due regard to costs the resultant interest burden must be met out of taxation. This burden has been growing at a rapid rate. In the last annual report Mr J. A. Norris (Auditor-General for Victoria) concluded that "the losses in connection with State-owned undertakings and State ventures are largely responsible for the present financial difficulties." Mr Norris does not suggest that these losses are irrecoverable or that the enterprises cannot be placed on a more satisfactory financial basis.

It is, indeed, the task of financial reconstruction

to apply rigid financial tests to State enterprises by separating them from the budgets and giving them a capitalization upon which interest and depreciation can be paid. Such a procedure would be a stimulus to efficiency, and, in part, a guarantee against unsound expenditure in the future. The careful methods of investigation initiated by the Development and Migration Commission should be applied to all loan expenditure. Such investigation would act as a deterrent to unprofitable development. We cannot now avoid the losses due to past mistakes. Firm action must be taken to prevent the recurrence of similar errors in the future, and for this purpose the closest scrutiny of loan expenditure should be insisted upon.

## XI. BALANCING BUDGETS

FOR some time before the present acute economic crisis weaknesses in Australian public finances were apparent. The fixed interest charge on the public debt was rising, expenditure on social services was expanding, and despite increases in taxation it was more and more difficult to balance Budgets. For the year 1928-29 the recorded deficits in the accounts of the States and the Commonwealth amounted to £3,600,000 and for 1929-30 to £11,000,000. There was no valid excuse for deficits prior to 1929-30, and for that year the deficits were far too large. Up to 30 June, 1929 the national income was more than sufficient to meet the revenue requirements of prudent finance. Taxation had, in fact, increased from £12 4s. 7d. a head in 1922-23 to £14 a head in 1929, an increase of fourteen per cent. In this period the index of productive activity constructed by the Commonwealth statistician does not show an appreciable increase. Australian taxation was, therefore, rising while productivity was practically stationary. Despite the increase in taxation, Governments were not balancing their Budgets.

## THE DECLINE IN REVENUE

It is well to remember these facts at the present time. Under normal conditions it would not have been difficult to place public finance on a sound basis. With a national income at the 1928-29 level and a prudent check upon expenditure, minor adjustments in taxation and the charges for public undertakings would have sufficed. No such simple remedy is adequate for the present difficulties. The national income has fallen, and Government revenue cannot be sustained at its former level. The receipts of public undertakings are falling because the demand for the services they render has declined. The post-office is likely to suffer less than most undertakings, and may be taken as an example. Its revenue for the quarter ending 30 September, 1930 was £3,280,000, compared with an estimate of £15,080,000 for the whole year. The discrepancy between actual and estimated receipts for other undertakings will be greater.

Taxation receipts show the same failure to realize anticipations. For the half-year, July-December 1930 excise revenue—very responsive to changes in national income—was £5,600,000 compared with an estimate of £11,800,000 for the year. If there is no further decline the deficiency on the year will be sixteen per cent. Present

indications are that Customs revenue will fall short of the estimate by twenty-five per cent, despite increased duties. No indication of the decline in income tax receipts is yet available. It will, however, be substantial, because the fund from which it is paid has itself fallen. Rates of tax on individual income have been increased, but they cannot make up the deficiency caused by the fall in national income.

#### REDUCING EXPENDITURE

In view of these facts it is idle to attempt to balance budgets merely by increasing revenue. The Commonwealth Government endeavoured to do so, but it has already become obvious that anticipations will not be realized. Despite increases in income tax and Customs and excise duties, and the new sales tax, the revenue cannot be sustained. It is necessary, therefore, first to accept the unpopular, though sound, course of reducing expenditure; and, next, to seek other methods of replenishing revenue.

The first task is the easier, though it is by no means as simple as the critic of Government expenditure imagines. The interest on the public debt of the Commonwealth and States amounts to £55,500,000, nearly thirty per cent of the total expenditure. The economies in expenditure must,

therefore, be made in the remaining seventy per cent. Working expenses on railways amounted to twenty-three per cent of total expenditure, education to six per cent, and pensions to ten per cent. Until recently the railways were partly working under awards of the Arbitration Court, and there are political obstacles to economies. On the other items listed, Governments are reluctant to decrease expenditure. Salaries are regarded as the most fruitful source of economies, and some States have already taken this course. But it does not appear that other items of expenditure can escape some reduction under present conditions. Business undertakings run by Government must conform as far as possible to the rule of business and reduce services that are unprofitable, despite political opposition. Social expenditure that was possible in more prosperous times cannot now be maintained on the old scale. Communities, like individuals, are forced to accept a scale of expenditure that can be financed from income, and when income fails, a reduction in expenditure is inevitable.

#### REPLENISHING NATIONAL INCOME

But the decline in public expenditure necessary to meet the situation will be far more serious than is generally realized. National income has fallen more than ten per cent. The loss of exports and



overseas borrowing amounts to ten per cent; and there are the indirect losses which are very serious under the present conditions of depression. If the total decline is placed at fifteen per cent, the corresponding fall in Government revenue would amount to nearly £30,000,000. If increased taxation can recover £10,000,000 of this there is still £20,000,000 to be met. A reduction in Government expenditure of £20,000,000 would have to be made over a field comprising seventy per cent of total expenditure. Fixed interest charges amount to the other thirty per cent. The fall in Government expenditure in the field in which economies would have to be made would, therefore, amount to one-seventh.\* Economies of this order must be made unless revenue can be restored.

There is a limit to the increase in revenue to be derived from increasing rates of taxation or devising new methods of taxation. The percentage of taxation on national income at its present level will become too heavy a burden, and the most satisfactory measure of relief lies in efforts to replenish national income. Government finance

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\* The aggregate deficits of all Australian Governments are estimated at from £25,000,000 to £28,000,000 this year. The Committee that examined this problem in February for the Conference of Commonwealth and State Ministers suggested economies amounting to thirteen per cent of all expenditure, except (a) fixed charges for interest and sinking fund, (b) exchange charges and (c) payments to the States by the Commonwealth. This agrees very well with my provisional estimate. The report is reprinted in Shaan and Copland's *The Crisis in Australian Finance, 1929-31*.

cannot be considered apart from the general economic situation, and if the drift towards reduced output in industry and increasing unemployment continues the task of balancing Budgets will become even more serious. Governments, therefore, are vitally interested in the restoration of economic equilibrium and the prevention of further losses of national income.

## XII. THE RESTORATION OF ECONOMIC EQUILIBRIUM

BEFORE outlining proposals for restoring economic equilibrium it will be desirable to restate the nature of the problem confronting Australia. There has been a loss of national income from exports and overseas borrowing of ten per cent. This is the first loss. It has reduced the spending power of export industries and of industries dependent entirely upon the expenditure of loan money. This has inevitably been followed by a reduction in the demand for the products of other Australian industries, and there has consequently been a secondary loss of national income. Increasing unemployment, falling Government revenue, and lower profits in industry generally are unmistakable evidences of this secondary loss. Its magnitude cannot be estimated, but in the present condition of depression it is increasing each month. It arises from the derangement of industry caused by the first loss, and will continue to grow while this derangement persists.

As economic activity is restored the secondary loss will be made good, and the final loss will be reduced to the amount of the first loss.

#### DISTRIBUTING THE LOSS OF INCOME

Obviously it is impossible here to furnish all the details of a proposal for restoring equilibrium. Readers should refer to what has been written on the subject elsewhere in this volume, to chapter six of my book on *Credit and Currency Control*, and to a paper on "The Restoration of Economic Equilibrium" published in the November (1930) issue of the *Economic Record* (the journal of the Economic Society). We commence with the first loss of income. At present it is borne by export producers, unemployed wage-earners, and recipients of business profits. It has to be spread over all producers. This may be done by reducing wages and salaries of the employed wage-earners by ten per cent, and by increasing the tax on income from property. By these methods the loss of income will be spread over all producers with reasonable fairness. The quicker this adjustment is made the sooner will the process of economic recovery be initiated. The fall in real wages will lower the costs of production over the whole field of industry; bringing partial relief to export producers, and enabling Australian industries to compete more effectively with imports. And the

increased property tax will assist in replenishing Government revenue. Thus the equitable distribution of the loss of income is also an important step in the process of economic readjustment.

### MONETARY POLICY

But these measures alone are not sufficient for the speedy completion of the process. Consider the position of the export producer. He sells his goods at very low prices, and his costs have to be met at high Australian prices. He has also to meet a heavy burden of fixed interest payments that are not readily adjusted to export prices. It is vital that the volume of export production should be maintained, and that the export producer should be compensated as far as possible for his severe loss of income. Falling internal prices can bring him partial relief only. If prices fall rapidly there will be a further disorganization of industry and finance, and this will temporarily increase the secondary losses of income. It is imperative to avoid this disorganization, and to give the export producer immediate relief. This can be done by a policy of stabilization, pending a general economic recovery. If it was desired later to reduce the price level, the process of deflation could be carried out slowly without undue distress.

The policy of stabilization aims at keeping general prices stable and so avoiding the disturbances due to a mere monetary readjustment. For this purpose, it would be necessary to raise exchange rates to perhaps twenty per cent, making £120 (Australian) exchange for £100 (British). This rate of exchange would recognize the difference in the price levels of the two countries. Any tendency of the higher exchange rate to increase the prices of exportable and imported goods would be offset by the fall in real wages, and prices would remain stable. The carrying out of this policy could be left to the Commonwealth Bank and no political interference need be feared. The bank would undertake to buy and sell exchange at the fixed rate, and at the same time initiate a policy of buying Government securities. The latter action would (a) sustain the credit structure of the trading banks, (b) facilitate conversion operations by raising the price of securities, and (c) secure some reduction in the rate of interest. The test of the success of this policy would be found in movements in the Australian price level. As long as prices did not rise the policy could be continued. If prices rose a reversal of policy by selling Government securities would be necessary. Such operations are carried out by all central banks.

## RESTORING ECONOMIC ACTIVITY

How would this policy affect general economic conditions? The higher exchange rate would increase the income of export producers when measured in Australian currency. If at exchange parity export production amounted to £100,000,000 the addition to the income of export producers would be £20,000,000. This would enable these producers to meet Australian costs and to continue in profitable production. Their spending power would be partially restored, and their demand for the products of other Australian industries would be increased. The loss of income originated with export producers, and this proposal restores it at this source. The higher exchange rate and the fall in real wages would also enable Australian industries to compete more effectively with imports, and some expansion of industry would take place from this cause. The net effect would be to reverse the present tendency to reduced output, and eventually to make up the secondary loss of income. The volume of export production could probably be maintained at its former level, and imports would eventually be reduced by the amount necessary to leave a margin for the payment of interest on the oversea debt. Recovery would be quicker under such an arrangement, but it must not be expected to produce startling results in a short time. No attempt

is made to cover up the real sacrifice Australia is required to make. Such a sacrifice cannot be avoided, but it would be accomplished with far less disturbance to industry under a policy of stabilization than under a policy of rapid deflation.

#### ADDENDUM

THE banking policy enunciated here has been pursued in recent months. Exchange rates rose to thirty per cent in January, and the Commonwealth and private banks have been financing government deficits to such an extent that the overdraft of Governments in London and Australia at 28 February, 1931 amounted to £28,000,000, and their holdings of Treasury Bills in Australia to £12,000,000. There has consequently been an increase in central bank credit and a rise in exchange sufficient to stop the downward drift of the price level, and even to raise it as soon as confidence is restored. The Commonwealth Arbitration Court has reduced the Basic Wage by ten per cent, and the chief obstacle to recovery now is the failure of governments, notably the Commonwealth and New South Wales, to reduce expenditure on the lines suggested in this book. In view of the misunderstandings that have occurred concerning this monetary policy it is necessary to repeat what I have already said here and else-



where. "The monetary policy proposed must not be divorced from the general scheme of which reduction in wages and salaries, public economy and high taxation of fixed incomes are essential parts." (*Economic Record*, Nov. 1930, pp. 186-187).

The use of the word "stabilization" has perhaps been misleading. It is easy to assume from it that a central bank may stabilize the general level of prices, but it was not intended to convey so precise a meaning. In urging a middle course between inflation and deflation the name "stabilization" seemed to convey the right idea. No one will question the assumption that a high exchange and an increase in central bank credit will tend to reverse the downward movement of prices.

### XIII. GOVERNMENT FINANCE AND INFLATION

#### 1. HOW INFLATION BEGINS

RECENT discussions on the issue of credit or of bank-notes as a cause of inflation have diverted public attention from a much more serious aspect of the present situation. In the experience of all countries that pursued a policy of inflation after the war, the process of increasing the note issue and expanding credit had its origins in the exigencies of public finance. In some cases, notes were issued to meet budget deficits. This is the crudest form of inflation, but there are other means of meeting Government deficits that are equally inflationist. Governments may secure increased overdrafts at the ordinary banks or at the central banks, or they may issue treasury bills to meet their deficits. In either way there is an expansion of credit which may be followed by an increase in the note issue for the purpose of maintaining the cash reserves of the banks.

In normal times, all Governments are indebted

to the money market through overdrafts at the banks or through the issue of treasury bills. This, however, is a temporary indebtedness in lean periods which, in the normal course of events, is met from the proceeds of taxes or other revenues. No inflation can follow such a practice, because the indebtedness is created against the anticipated proceeds of revenue and these are ultimately realized. Where, however, the temporary advances to the Governments are not met in this way, there is a permanent increase in credit whether additional notes are issued or not. The essence of inflation is such a permanent increase in credit to liquidate which there are no resources. Whether this increase in credit takes place in public finance or in private finance, the effect is the same. The community has obtained an increase in spending power but the production of goods and services is not increased in proportion. In these circumstances a rise in prices is inevitable.

Mr R. G. Hawtrey, of the British Treasury, a world-renowned authority on currency and banking, describing the process of inflation during the war, states in an article in the *Encyclopædia Britannica*: "Essentially what happened was that the belligerent governments found their liabilities outstripping the funds they could raise by taxation and by the borrowing of genuine investible savings. After exhausting every expedient, they

were faced with the imperative necessity of payment, and rather than let their current liabilities get indefinitely into arrear, they practically printed paper money for the purpose of paying. In form the governments 'borrowed' from the central banks of issue, and the central banks placed at their disposal, in the first instance, not actual legal tender notes, but a credit on current account. In continental countries the credit would be quickly drawn out in notes. In England, where cheques were more freely used, this would not necessarily be so, but deposits at the Bank of England count as cash to the money market and the banks in practically the same way as notes. Credit expanded in proportion, and when notes were required they were issued. As the quantity of money in each of the belligerent countries grew, the value of its currency unit fell; in other words prices rose. The foreign exchanges likewise became adverse."

The present position of Government finance in Australia involves real dangers of this nature. The country has lost a considerable percentage of its national income. Though some economies have been made in public expenditure, they are by no means sufficient in the circumstances. This is particularly true of Commonwealth expenditure. If expenditure is maintained at present levels, one of two courses must follow.

First, taxation may be increased to meet the deficit. This course involves a considerable transfer of funds from taxpayers to the Government. Private expenditure is reduced accordingly, and there is less income available to support the existing amount of credit that has been extended to private business. Business men and producers generally find themselves unable to meet interest on their borrowings. If this business credit were reduced accordingly, there would be no fear of inflation, because the Government would have balanced its budget, and the spending power of the people as a whole would have been reduced to an amount consistent with the income available after taxes had been paid. But this course involves very heavy taxation, and a considerable reduction of bank advances for all productive purposes. The economic effects would be serious. Heavy taxation would greatly burden industry, and a forced reduction of private credit would be involved.

The second course is the maintenance of a high level of public expenditure without the revenue to meet it. It is obvious that this condition of affairs can be sustained only by the issue of credit to Governments to meet their commitments. In a crisis where the fall in the national income has so seriously depleted Government revenue, it is always necessary to issue some credit to the Gov-

ernment, pending the completion of the readjustments in Government expenditure and revenue. But this action can be confidently entered upon only when it is obvious that the process of readjustment is being vigorously pursued and will be completed in a reasonable time. If this is not so, Governments become heavily indebted to the banks or to the money market through the issue of treasury bills, and the credit so created is not accompanied by a proportionate increase in production and income.

Such a condition of affairs is inflation, whether the note issue has been expanded or not. If it continues long, the note issue must be expanded in order to maintain the cash reserves of the banks. It was in this way that inflation commenced in most European countries after the war, though no responsible treasurer or governor of a central bank would admit that notes were being issued in excess of the demand for them. This, of course, was true, but the increased demand for the notes was in itself the result of the inflation of credit caused by the increased indebtedness of governments, and the issue of notes only served to sustain this inflation and to provide a basis for further inflation. Australia must not overlook this object lesson. Inflation may be commenced in an insidious and obscure way, while we are wrangling over the proposals made by avowed inflationists

who would increase credit and the note issue in the most extreme and obvious way.

The published returns of revenue and expenditure for the Australian Governments as a whole show large deficits which are not being met from taxation, or other revenue. These deficits can only be met by borrowing in one form or other. As this borrowing is required to meet current expenditure that should be met from revenue, there is an increase in credit without a corresponding increase in production.

If this borrowing continues at its present rate, we shall drift into inflation in the same way as many European countries did after the war. An attempt to maintain public expenditure at its present level involves this danger. Expenditure must be reduced. The whole gap between expenditure and revenue cannot be bridged by economies. Still less can it be bridged by taxation. A drastic reduction in expenditure is a first condition of balancing budgets within a reasonable time, and therefore of avoiding the inflation into which we are drifting. The responsibility for taking this step rests mainly with the Commonwealth Government, which up to the present has not followed the example of the States in making economies, much less given a lead to them.

Those who advocate an expansion of credit to maintain a scale of public expenditure that the

community cannot afford are walking on dangerous ground. They have the example of many European countries before them, and what happened there should cause the most confirmed inflationist to pause before committing the country to a disastrous experiment. It is quite forgotten that European countries that inflated their currencies did not escape the necessity ultimately of balancing their budgets. Inflation caused great social and financial disturbance, upset the basis of all monetary contracts and lowered the standard of living of many classes. The reconstruction of public and private finance was in the end attained by much greater sacrifices than would have been necessary at the outset. By pursuing a bold policy of economy Australia can now reconstruct her finances with the smaller initial sacrifice. The longer she delays the more difficult will be the task of reconstruction and the greater the sacrifices involved.

## 2. TRENDS IN AUSTRALIAN PUBLIC FINANCE

The tables and graphs at the end of this section are based upon statistics given in the *Finance Bulletin* (No. 20), published by the Commonwealth Statistician. Attention may be drawn to some outstanding facts. The figures for production must not be confused with national



income. They include only that part of national income (about two-thirds) upon which the Commonwealth Statistician collects statistics. In a short period, say from 1924-25 to 1928-29, changes in production can be regarded as a fairly accurate measure of changes in national income. It will be noted that in 1924-25 production was at its maximum. The high prices of wool and wheat largely account for the great increase in production in 1923-24 and 1924-25. The fall in the ratios of taxation, expenditure and interest to production in these years are also explained by the increase in production. Graph I. and Table I. show that taxation, expenditure and interest were, on the whole, increasing up to 1924-25. After that year the increase was in all cases even greater. Production, however, declined and the most disturbing feature of the statistics is the increase in the ratios after 1924-25. This is brought out clearly in Graph II. Thanks to the buoyancy of production the burden (as measured by the ratios) of expenditure, interest and taxation was declining from 1921-22 to 1924-25. Production could not be sustained at the high level of 1924-25, and as all elements of government finance increased there was a pronounced rise in the ratios. If the burden of expenditure, taxation and interest is measured by

the ratios given in Table II. the following are the percentage increases in the burden over the whole period 1919-20 to 1928-29:—

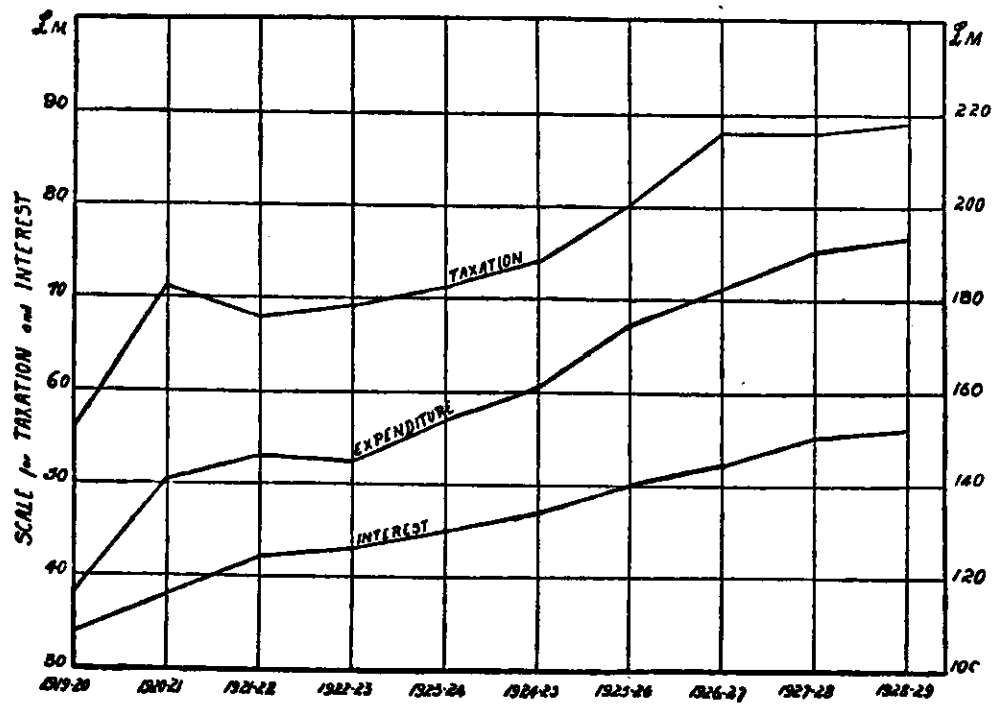
Commonwealth Expenditure . . . .	19%
State Expenditure . . . . .	28%
Total Expenditure . . . . .	23.4%
Commonwealth Taxation . . . .	3%
State Taxation . . . . .	75%
Total Taxation . . . . .	21%
Overseas Interest . . . . .	39%
Internal Interest . . . . .	13%
Total Interest . . . . .	25%

This brings out very strikingly the increase in the burden of taxation and interest since the war. The great increase in State taxation is some indication of the degree to which loan expenditure and State enterprises have failed to produce the necessary revenue to meet interest on capital. The increase in the burden of overseas interest is an unpleasant reminder of (a) the rapid rate at which the overseas debt has been accumulated in the past ten years, and (b) the rise in the average rate of interest on the debt. Figures for production and expenditure for 1929-30 comparable with those given in the tables are, in part, estimates, but they are sufficiently accurate to indicate the serious situation that has now developed. Taxation has increased and a heavy fall in production taken place on account of the

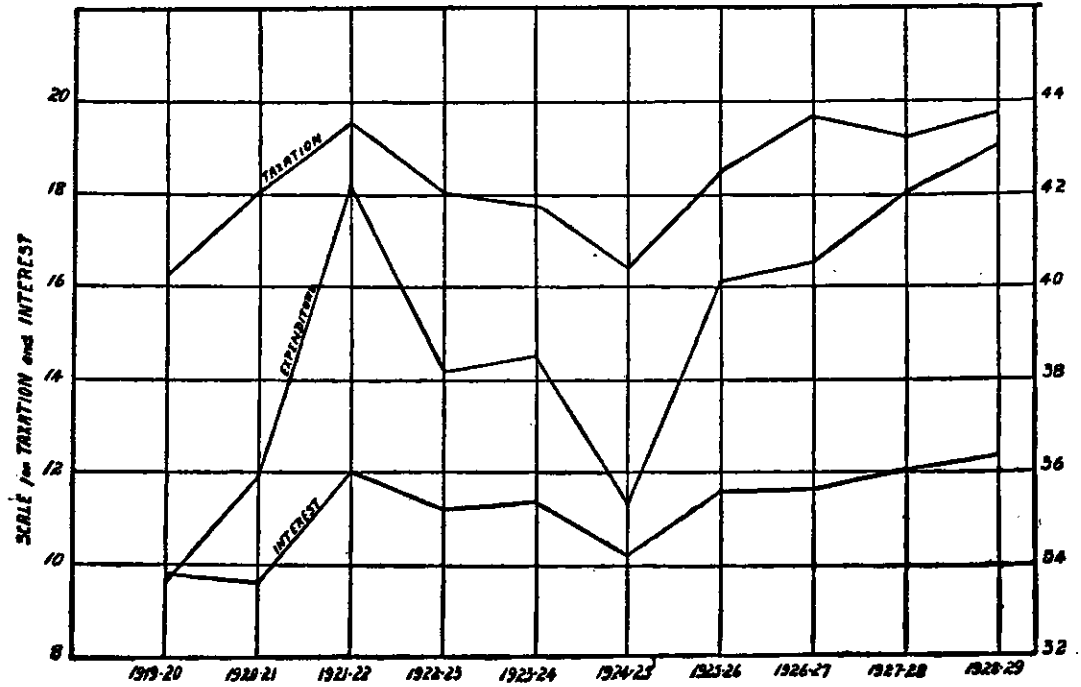
fall in prices of export goods. The burden of interest, taxation and expenditure has, therefore, risen again in 1929-30; but on this occasion to an alarming height. It must be remembered that deficits have been incurred by most governments in the past two years, and had budgets been balanced, taxation would have been still higher. Thus there was a deficit of £11,000,000 in 1929-30. According to the report of the Committee appointed by the Loan Council to investigate the financial position of Australia and prepare information for consideration by the Conference of Commonwealth and State Ministers, the floating debt of the Australian governments at 28 February, 1931 amounted to £55,500,000\* and it is still increasing. With production declining it will be impossible to raise sufficient revenue to meet current expenditure, and there is no prospect of a loan to fund the floating debt. The present size and prospective growth of this debt is the greatest menace to Australian finance. While it is growing, inflation is proceeding and the degree of relief that can be procured from such a method of finance depends upon the firmness with which economies are made by Governments. The alternative is continued and increasing inflation as indicated in Section I.

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\* This report is published in Shann and Copland's *The Crisis in Australian Finance 1929-31*.



GRAPH I  
 AUSTRALIAN TAXATION, EXPENDITURE AND  
 INTEREST  
 SCALE FOR EXPENDITURE



GRAPH II  
 RATIOS OF TAXATION, EXPENDITURE AND  
 INTEREST TO PRODUCTION  
 SCALE FOR EXPENDITURE

**TABLE I**  
**STATISTICS OF PUBLIC FINANCE IN AUSTRALIA**

Year.	Expenditure.			Taxation.			Production.	Interest on Public Debt.		
	Commonwealth-	State.	Total.	Commonwealth-	State.	Total.		Overseas.	Australiam.	Total.
	£m.	£m.	£m.	£m.	£m.	£m.		£m.	£m.	£m.
1919-20	42.9	72.0	114.9	41.8	14.3	56.1	343.6	15.4	18.8	34.2
1920-21	56.3	83.2	139.5	52.4	18.2	70.6	390.5	16.4	21.4	37.8
1921-22	56.3	87.5	143.8	49.7	17.8	67.5	344.8	18.8	22.8	41.6
1922-23	54.4	88.3	142.7	49.9	18.7	68.6	379.4	19.1	23.7	42.8
1923-24	61.7	93.5	155.1	50.9	20.0	70.9	400.2	21.3	24.0	45.3
1924-25	57.9	100.2	158.1	52.8	21.7	74.5	454.1	21.9	24.9	46.8
1925-26	63.3	106.6	169.9	54.4	25.5	79.9	431.5	24.0	26.3	50.3
1926-27	68.0	114.1	177.1	59.0	29.5	88.5	447.4	24.8	27.4	52.2
1927-28	68.2	117.4	185.6	56.6	31.2	87.8	452.9	27.5	27.6	55.1
1928-29	66.2	120.3	186.5	56.3	32.4	88.7	447.9	27.5	28.0	55.5
1929-30	67.2	122.8	190.0	58.2	31.9	90.1	398.2	27.8	27.6	55.4

**NOTE.**—The expenditure of the Commonwealth excludes contributions to the States and other items included in State expenditure.

TABLE II  
**AUSTRALIAN PUBLIC FINANCE**  
 Ratios of Expenditure, Taxation and Interest to Production  
 (Each column is the percentage of the item to recorded production)

Year.	Expenditure.			Taxation.			Interest on Public Debt.		
	Common-wealth.	State.	Total.	Common-wealth.	State.	Total.	Overseas.	Aus-tralian.	Total.
	%	%	%	%	%	%	%	%	%
1919-20	12.5	20.9	33.4	12.1	4.1	16.2	4.4	5.4	9.8
1920-21	14.9	21.2	35.7	13.4	4.6	18.0	4.2	5.4	9.6
1921-22	16.3	25.4	41.1	14.4	5.1	19.5	5.4	6.6	12.0
1922-23	14.8	23.3	37.8	13.1	4.9	18.0	5.0	6.2	11.2
1923-24	15.4	23.3	38.7	12.7	5.0	17.7	5.3	6.0	11.3
1924-25	12.5	22.0	34.8	11.7	4.7	16.4	4.8	5.4	10.2
1925-26	14.7	24.6	39.3	12.6	5.9	18.4	5.5	6.0	11.5
1926-27	14.1	25.5	39.4	13.1	6.5	19.6	5.5	6.1	11.6
1927-28	15.1	25.9	40.9	12.4	6.3	19.2	6.0	6.0	12.0
1928-29	14.9	26.9	41.3	12.5	7.2	19.7	6.1	6.2	12.3
1929-30	16.9	30.3	47.8	14.6	7.9	22.6	7.0	6.9	13.9

**TABLE I**  
**STATISTICS OF PUBLIC FINANCE IN AUSTRALIA**

Year.	Expenditure.			Taxation.			Production.	Interest on Public Debt.		
	Common-wealth-	State.	Total.	Common-wealth-	State.	Total.		Over-seas.	Aus-tralian.	Total.
	£m.	£m.	£m.	£m.	£m.	£m.		£m.	£m.	£m.
1919-20	42.9	72.0	114.9	41.8	14.3	56.1	343.6	15.4	18.8	34.2
1920-21	56.3	83.2	139.5	52.4	18.2	70.6	390.5	16.4	21.4	37.8
1921-22	56.3	87.5	143.8	49.7	17.8	67.5	344.8	18.8	22.8	41.6
1922-23	54.4	88.3	142.7	49.9	18.7	68.6	379.4	19.1	23.7	42.8
1923-24	61.7	93.5	155.1	50.9	20.0	70.9	400.2	21.3	24.0	45.3
1924-25	57.9	100.2	158.1	52.8	21.7	74.5	454.1	22.9	24.9	46.8
1925-26	63.3	106.6	169.9	54.4	25.5	79.9	431.5	24.0	26.3	50.3
1926-27	68.0	114.1	177.1	59.0	29.5	88.5	447.4	24.8	27.4	52.2
1927-28	68.2	117.4	185.6	56.6	31.2	87.8	452.9	27.5	27.6	55.1
1928-29	66.2	120.3	186.5	56.3	32.4	88.7	447.9	27.5	28.0	55.5
1929-30	67.2	122.8	190.0	58.2	31.9	90.1	398.2	27.8	27.6	55.4

**NOTE.**—The expenditure of the Commonwealth excludes contributions to the States and other items included in State expenditure.



TABLE II  
**AUSTRALIAN PUBLIC FINANCE**  
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Year.	Expenditure.			Taxation.			Interest on Public Debt.		
	Common-wealth.	State.	Total.	Common-wealth.	State.	Total.	Overseas.	Aus-tralian.	Total.
	%	%	%	%	%	%	%	%	%
1919-20	12.5	20.9	33.4	12.1	4.1	16.2	4.4	5.4	9.8
1920-21	14.9	21.2	35.7	13.4	4.6	18.0	4.2	5.4	9.6
1921-22	16.3	25.4	41.1	14.4	5.1	19.5	5.4	6.6	12.0
1922-23	14.8	23.3	37.8	13.1	4.9	18.0	5.0	6.2	11.2
1923-24	15.4	23.3	38.7	12.7	5.0	17.7	5.3	6.0	11.3
1924-25	12.5	22.0	34.8	11.7	4.7	16.4	4.8	5.4	10.2
1925-26	14.7	24.6	39.3	12.5	5.9	18.4	5.5	6.0	11.5
1926-27	14.1	25.5	39.4	13.1	6.5	19.6	5.5	6.1	11.6
1927-28	15.1	25.9	40.9	12.4	6.3	19.2	6.0	6.0	12.0
1928-29	14.9	26.9	41.2	13.5	7.2	19.7	6.1	6.2	12.3
1929-30	16.9	30.3	47.8	14.6	7.9	22.6	7.0	6.9	13.9

## XIV. THE POSITION OF THE FARMER

### THE BURDEN OF PRICE DISPARITIES

THE accompanying graph was prepared originally by a committee of the Melbourne University Old Commerce Students' Association and published in the *Economic Record* for November, 1930. It is based upon the Melbourne wholesale price index number. To obtain the prices of farm products, Groups II., III., and IV. of this index number, consisting mainly of wool, agricultural products and dairy products, are combined. The index of industrial products is obtained by combining Groups V., VII., and VIII., comprising groceries, building materials, and chemicals. The comparison is by no means complete, but is the best available from the data published by the Commonwealth Statistician. The differences in the movements of the prices of the two groups are, however, so great that a considerable variation in the index numbers would be possible without upsetting the main conclusion to be derived from the graph, namely, that the prices of farm pro-

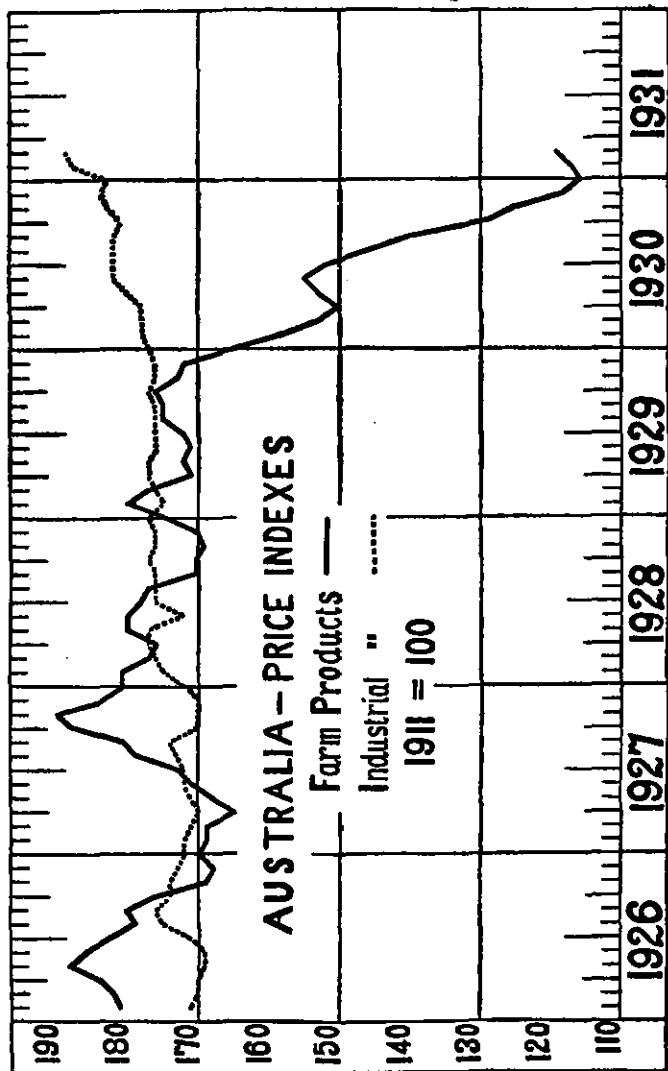
ducts have fallen very severely, while the prices of industrial products remain about their level of recent years. The actual figures may be given:—

(Base 1911-100)

	Farm Products	Industrial Products
1926, January .. .. .	181	171
1927, January .. .. .	169	172
1928, January .. .. .	181	175
1929, January .. .. .	180	175
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The prices of farm products are in the main determined by external markets, and cannot be sustained except to a small extent by tariffs and marketing controls. This is not so with industrial products, and there is little doubt that the substantial increase in the Australian tariff in the past eighteen months has sheltered industrial production to such an extent that a fall in prices has been avoided or greatly mitigated.

Whatever may be the causes of the disparity in the price movements of industrial and farm products, the existence of this disparity is one of the most serious problems confronting Australia at the present time. The movements in exchange rates



since the beginning of the year and the recent recovery of the wool market will doubtless show an upward movement in farm prices. But the sales tax, the primage duty, and the exchange rate will also provide additional shelter for industrial products, and may lead to a rise in the prices of these goods also. In this event, the farmers' position will be not less desperate than it is to-day. A high exchange rate is usually reflected sooner or later in rising internal prices unless some action is taken to reduce costs. It is for this reason that the all-round reduction of ten per cent in real wages and a general improvement in efficiency are necessary if the present exchange rate is to bring any real benefit to the farmer. For the same reason a reduction in the cost of government is urgently required if budgets are to be balanced under a high exchange rate and the burdens of taxation kept to a minimum.

## NOTE ON FURTHER READING

1. The following books deal with the fundamental elements of the Australian economy:

SUTCLIFFE, J. T.—The National Dividend (Melbourne University Press)

SHANN, E. O. G.—Bond or Free (Angus & Robertson)

BENHAM, F. C.—The Prosperity of Australia (King)

BLAND, F. A.—Budget Control (Angus & Robertson)

WOOD, G. L.—Borrowing and Business in Australia (Oxford University Press)

The Australian Tariff—An Economic Enquiry, by a Committee of Economists (Melbourne University Press)

2. For the present crisis the following should be consulted:

GIBLIN, L. F.—Australia, 1930 (Melbourne University Press)

SHANN, E. O. G., and D. B. COPLAND—The Crisis in Australian Finance (Angus & Robertson)

BRIGDEN, J. B.—Escape to Prosperity (Macmillan) Chapters 1-2

GREGORY, T. E. G.—Some Problems of International Finance (University of Adelaide)

3. Banking and monetary problems are discussed in:

COPLAND, D. B.—Credit and Currency Control (Melbourne University Press)

MILLS, R. C., and F. C. BENHAM—The Principles of Money Banking and Foreign Exchange (Angus & Robertson)

MACKAY, A. L. G.—The Australian Banking System (King) Early chapters on the history of Banking

DAVIDSON, A. C.—Central Reserve Banking (Angus & Robertson)

4. *The Economic Record*, the Journal of the Economic Society of Australia and New Zealand, published twice yearly, and available from the Secretary of the Society, the University, Melbourne N.3. or through any bookseller, contains important articles on all phases of the Australian economy. The annual subscription is 10s. Two important supplements have been published:—"The Marketing of Primary Products" (February 1928), and "The Economics of Australian Transport" (August 1930). Price, 5/- each.

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