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Some Economic Effects of the Australian Tariff

THE JOSEPH FISHER LECTURE
IN COMMERCE

GIVEN IN ADELAIDE

JUNE 25, 1936

BY

L. F. GIBLIN

RITCHIE PROFESSOR OF ECONOMICS IN THE UNIVERSITY OF MELBOURNE

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PREFATORY NOTE

In 1903 the late Mr. Joseph Fisher paid the sum of £1,000 to the University of Adelaide for the purpose of promoting, with the income thereof, the study of commerce at the University.

The "Joseph Fisher Lecture in Commerce" was founded as one result of this endowment.

The lecture is given biennially on a topic relating to commerce, industry, or finance by a lecturer who is appointed from time to time by the Council. The lectures are free, and are open to the public, and printed copies are afterwards distributed at the cost of the fund.

The present lecture, which is the seventeenth of the series, was given by Professor L. F. Giblin, Ritchie Professor of Economics in the University of Melbourne.

The following is a complete list of Fisher Lectures given since their foundation:

- *1904—"Commercial Education", by Henry Gyles Turner, Esq.
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- *1908—"The Influence of Commerce on Civilization", by J. Currie Elles, Esq.
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- *1921—"Currency and Prices in Australia", by Professor D. B. Copland, M.A.
- *1923—"Money, Credit, and Exchange", by J. Russell Butchart, Esq.
- *1925—"The Guilds", by Sir Henry Braddon, K.B.E., M.L.C.
- 1927—"The Financial and Economic Position of Australia", by the Right Hon. S. M. Bruce, P.C., C.H., M.C.
- 1929—"Public Finance in Relation to Commerce", by Professor R. C. Mills, LL.M., D.Sc. (Econ.).
- 1930—"Current Problems in International Finance", by Professor T. E. G. Gregory, D.Sc. (Econ.).

PREFATORY NOTE

1932—"Australia's Share in International Recovery", by A. C. Davidson, Esq.

1934—"Gold Standard or Goods Standards", by L. G. Melville, Esq., B.Ec., F.I.A.

1936—"Some Economic Effects of the Australian Tariff", by Professor L. F. Giblin, D.S.O., M.C., M.A.

Copies of these lectures, except those marked with an asterisk, which are out of print, may be obtained free of charge on application to the Registrar, University of Adelaide.

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SOME ECONOMIC EFFECTS OF THE AUSTRALIAN TARIFF

The free trade controversy has had many vicissitudes in Australia. It has nearly always divided political parties. We used to think of England as the inviolable stronghold of free trade. That thought on the one side and the growing call of nationalism on the other made a clear-cut decision difficult. For many years the Labour Party was in a serious dilemma with the tradition of passionate free trade inherited from British democracy to be balanced against the obvious advantage of a growing industrial electorate; and the official attitude was one of indifference. The safe answer to a heckler was that the difference between protection and free trade was precisely the difference between Tweedledum and Tweedledee: they were equally capitalistic devices for exploiting the worker.

On the other side the country producers maintained a faith in free trade which was at first fully justified by their economic interests, and was only gradually sapped by the discovery that many of them could get as much out of protection as the factory-folk. To this day the Country Party has been disinclined to admit that when its interests are at stake it can give lessons in high protection before which the efforts of the manufacturers sink into mediocrity. The left wing of the Conservative side had, however, its roots in the cities, and was pushing national ideals more strongly than the Labour Party, hampered as it was by the British tradition of its pioneers. These two elements of the forces opposed to Labour were sometimes in opposition, sometimes in uneasy alliance. So it has come about that this question of free trade *versus* protection, though of supreme economic importance, has seldom been the dominant issue at elections and, at any rate during the last twenty years, no Australian government has come into power with a definite mandate for or against protection. Gradually the cause of free trade has weakened. The sudden and complete abandonment of free trade by Great Britain during the depression has put the last nail in its coffin as a pure policy, and only a handful of Elijahs are left re-affirming their faith to an uninterested world. The practical questions now are—as they have always been for the economist—the degree of protection, the direction and the form in which it can most usefully be applied. From this field comes my subject to-night. My aim is to put before you

some of the conclusions which can, perhaps rather tentatively, be reached from the examination of our experience with protection in recent years.

I must not be understood as dismissing the theoretical argument for free trade. A convincing case can be made for its operation in an ideal world. In the nineteenth century, in the first fine careless rapture of industrialism plus international trade, that ideal world seemed not so very remote, though I think there were always reasons for thinking its apparent nearness a mirage effect. The vision of it at any rate has faded, and we have now a fairly unanimous conviction that it can, at least for this generation, be disregarded in the practical conduct of affairs.

Up to 1927 neither parliaments nor press had taken much interest in the broad problem of the economic effects of a protective tariff. All parties were as a rule content to see the immediate and partial effect which supported their views, and to be blind to all others. The Commonwealth Government, however, in 1927 began to feel some uneasiness about the effects of the policy they were carrying out, and the Prime Minister (Mr. Bruce) asked a number of economists and statisticians to form a committee and report on the economic effects of the Australian tariff. The members of this committee had to confess that though they had discussed this problem for years, theoretically or practically, they had never arrived at a definite judgment on the Australian position. They applied themselves therefore to the task with an open mind, and in 1929 produced under some difficulties a joint report, which was published under the title of *The Australian Tariff*.

Let me remind you of some of their conclusions. It was called an economic enquiry. It began, however, by postulating the very uneconomic condition that population could not be allowed to leave Australia—that in fact population must grow at, at least, the rate of natural increase. It was thought possible that Australia might have had a maximum income per head under free trade—with perhaps only half the population devoting itself to working the richer natural resources in wool and wheat and metals. That was rejected as an impracticable alternative. The committee found that without protection it would have been impossible to maintain the same population at the same standard of living. Protection no doubt was strictly uneconomic; it imposed a cost which was the price that had to be paid to maintain a growing population at the Australian standard of living.

The problem was one of balancing two possibilities. Protection no doubt made everything dearer, and in particular raised the costs of production of export industry. With the lower costs under free trade.

would it have been possible to expand export industry—wool and wheat and butter—so as to balance the loss of protected industry? Expansion of rural industry meant expansion into worse land with higher costs. It looked as if wool had reached about its limit, and in some places overpassed it. A good deal of wheat-growing had certainly passed it; while butter had gone so far that heavy protection by means of a home price was required to maintain production. Even with lower free trade costs the expansion of export industry to the required extent was judged to have been impossible. That judgment was made in the days of high export prices, and at the time it seemed a bold one. It surprised, indeed, the authors of it. Now-a-days it is an obvious common-place. Even in 1928 the future of export prices—particularly wheat—was looking very dubious. This was, however, kept resolutely out of the argument, because the authors were concerned with what had happened or what could have happened up to that date. Now, looking back over seven years of depressed export prices, we can easily appreciate how much we owe to the growth of secondary industries. As it was we came near to a breakdown in 1931-32. Free trade would have meant doubling our wheat acreage and large increases in our other exports. Export prices would have fallen still lower, and we should have been much more dependent on them. External default would have been the least of our penalties for backing the wrong horse.

For it was a gamble. The reasons for which most people (and their Parliaments) backed protection were probably quite unsound—demonstrably false. But it turned out a winner.

There is, then, little disagreement about the necessity of the protective policy to-day. The general principle is admitted, but its application is still controversial. How hard should the policy be pushed? And in what directions? How can we get the greatest advantages at the least cost? Then we should like to know the cost even if it is a necessary cost. And we want to know how the cost is distributed between classes, and particularly between States. On some of these matters I wish so far as time will permit to review the state of our knowledge—or ignorance.

The committee in 1928 based their consideration on an estimate of what they called the excess costs due to protection. Let us be quite clear what this means. Excess costs were defined as the amount by which the prices of *Australian* products were raised by the policy of protection, above those of duty-free imports. No account was taken of the increase in price of imports on account of customs duties. These duties went into revenue used for the presumed necessary expenses of government, and it was presumed further that if this revenue had

not been provided incidentally by protective duties, it would have been raised deliberately by revenue duties or other indirect taxation. The duties on imports therefore did not raise prices for the community as a whole more than they would have been raised in any case.* The incidence of these duties might have serious effects for different classes of the community—perhaps in their final effect for the whole community—but that was a question of wise taxation, not of protection. The excess cost due to the policy of protection was the excess above free trade prices for the Australian products only.

Let us look a little more closely at this excess price and its effect on the community. It will be convenient to consider separately two classes of goods which at this stage we may describe roughly as luxuries and necessities. The more precise definition of luxuries will be goods of which the price does not enter into the costs of production.

PROTECTION OF LUXURIES.

For a sample luxury take a motor car used for pleasure. I recognize the difficulty that every individual can make a convincing and often heart-rending case for regarding his or her motor car as a strict necessity—but you will, perhaps, concede that some of the other people's cars are luxuries. However, the conscientious objector may think alternatively of wireless apparatus, cigars, lipstick, or top hats, according to fancy. Top hats perhaps arouse the fewest passions, so let us express it in terms of top hats.

Let us suppose that top hats can be imported at one pound, duty free, and there is a duty of 50 per cent. Then the wholesale price of imported hats will be roughly 30s., and the Australian maker can then keep his price a little under 30s. and displace imports by home-products. The excess cost will be nearly ten shillings for every hat. (Internal competition and other factors may reduce the price and the cost, but we are concerned for the moment only with the maximum excess cost.) Let us suppose that Adelaide requires 400 top hats every year. They will now cost £600 instead of £400, in addition to the cost of retailing, which will be the same in both events. The making of these hats will employ, let us say, three men in Adelaide, and put out of employment two men overseas. If Adelaide insists on its top hats—if the demand

* £1m. raised in customs duties would of course raise retail prices by much more than £1m.; but equally so would £1m. raised by excise or sales tax which must be assumed to be the alternatives. In respect to the excess costs of Australian production due to protection, the total excess costs, as measured in *The Australian Tariff*, is in reference to prices at the factory door. The further additions to retail prices were taken into account by reckoning "retailing" as a separate sheltered industry, and estimating the excess costs which fall on it and were eventually passed on to unsheltered incomes.

is very rigid—then the purchasers will pay the £600 instead of the old £400 for imports, and have £200 less to spend on other things—probably clothes. So one man will lose employment on making those other clothes, and the net result on employment will be two more employed in Australia, two less employed overseas. If, on the other hand, Adelaide prefers to have fewer hats and spends only the same £400 on them, it will employ only two additional men, and no others will be displaced. Whatever response in fact Adelaide makes to the new conditions of supply, the first net effect will be two more men employed in Australia, two less overseas, and Adelaide will have to get along with fewer top hats or other things. For the world as a whole employment is the same as before, and the standard of living in Adelaide has been reduced. This is the essential loss, incidental to all protective policy.

These statements imply in both countries concerned a reserve of unemployed people. With full employment in either country, some modification of the statement would be necessary, but the net cost of protection would be even greater with full employment in Australia.

I have said "the *first* net effect", and there will of course be further effects—repercussions of increased or decreased income and employment. The new men employed will give employment to others, and these again to others in a diminishing series. The total will depend on many circumstances—the proportion of new income spent on imports or overseas interest, and particularly on the extent to which the factors of production are already employed. In Australia in recent years, with much unemployed resources in labour, land, and capital goods, it may be reckoned that one additional man re-employed in unsheltered industry* would be followed ultimately by the re-employment of two others. So the total net new employment in Australia on account of displacing £400 worth of imported top hats would be six men. The total unemployment caused in the country which supplied the top hats would depend on conditions in that country, and might be more or less than for Australia. Roughly, one may say that the greater the unemployment and the unused capital equipment, the greater will be the secondary effects of an increase of employment. On account, however, of the relatively large unused natural resources of Australia, reper-

* i.e. export industry or industry competing with imports. The fall in imports of top-hats will of necessity be balanced by the consumption of imports of the six men re-employed (or of six men of additional population), so that the balance of external payments will not be altered. I have for simplicity kept the balance of payments out of the main argument, but it may be useful to remind the reader on occasion that protection does not of necessity improve the balance of payments, except in so far as it leads to an abnormal restriction of consumption. The ratio of imports to consumption is lowered, but this is balanced immediately by the increased consumption of imports due to new employment (or population).

cussions of increased income will tend to be greater here than in most countries.

From the purely Australian standpoint, we should have an increase in employment by perhaps six, at the cost of some lowering of the standard—some loss of consumption goods. At the present time it may seem a very reasonable price to pay for increased employment—the going without a certain amount of luxury expenditure. It does not help the world depression, but as a defensive, self-protective measure, it is clearly justified in emergency—with the hope that a growing efficiency in Australian production will in course of time make up the loss in the standard of consumption, which must be its immediate sequel.

Coming back to the net first effect on employment, from which the secondary effects can be deducted by multiplying by about three, we see that the higher the protection required or used, the less will be the resulting new employment. The excess costs always stand for a loss, a certain amount of consumption foregone. Corresponding to this loss of consumption will be, in general, a loss of employment to be set against our first gain. (This is the man making other clothes who lost his job in the top hat illustration.)* It will be seen that the net new employment will correspond to the total new production *less* its excess cost, or in other words to the free trade value of the new protected production. The greater the excess costs the less the net gain in employment. For the same excess costs—for the same loss—it will be seen that the net new employment will vary inversely as the degree of protection required and used. Suppose we are prepared for excess costs of £1m.—to go without consumption goods to that amount. If certain new production requires duties of 50 per cent., then for an excess cost of £1m., we should have £3m. of this new production, with £2m. as the cost of displaced imports, and the net new employment would be (say) 10,000 men. But if new production could be found which could carry on with 25 per cent. protection, then the resulting new production would be £5m., the cost of displaced imports £4m., and the net new employment on the same basis of calculation would be 20,000, or twice as great. For the same cost—for the same loss in consumption—you get twice the benefit on account of the lower degree of protection required. Halve the percentage of the protective duty, and you double the resulting net employment. Double the percentage, and you halve the resulting employment.

Now a country at any time is able and willing to make a certain effort, to stand a certain loss, to put up with excess costs to a certain

* This will not be true if the consumption of the protected goods is reduced, but we must assume that the aim of protection is to supply the same quantity of home products as was previously imported.

total amount. It is therefore of the highest importance to make the effort go as far as possible. It is absurd to fritter it away on protecting industries that require 50 or 60 per cent. protection, when it would go twice as far with industries that could live with subsidies of 25 or 30 per cent.

PROTECTION OF NECESSARIES.

The effect of protecting necessities is not so simple. In Australia it is more far-reaching and at the same time more measurable than in most countries, by reason of our methods of wage-determination. Australia is unique in fixing most wages and many salaries in accordance with an index number of retail prices, which takes account of nearly all ordinary food and clothing, housing, household gear, and other miscellaneous expenditure. Anything covered by this index is for our present purpose a "necessary", and you see that through rent it covers all kinds of building materials. (There are other necessities not covered by the index number, as we shall see.) It follows that any alteration of price over a very wide range of goods in common use affects wages almost at once under Australian conditions, and will therefore have immediate and far-reaching effects on the cost of production.

The only large exception to this close relation of wages and retail prices is with farm employment. Most farm wages are not so related, and they vary rather with the income of the farmer, which itself depends mostly on export prices. We may therefore rather broadly regard the farm labourers, who number about 10 per cent. of total bread-winners, and the farmers, who also number about 10 per cent., as making one class which is affected for better or worse in the same way by all variations in prices, whether internal prices or export prices.

Let us now consider the effect of the protection of some necessary such as sugar, or butter, or working boots, or dungarees, or teapots, or galvanized iron. But there is a further distinction between factory goods and primary products, and we will take factory goods first—say, teapots.

THE PASSING ON OF COSTS.

Suppose teapots are made here with 50 per cent. protection, so that £600 is paid for teapots that could be imported duty free for £400, and we have as the first effect the employment of three more men. But here there will be little question of cutting consumption on account of higher prices. The great majority of the people using these teapots will have wages or salaries depending on retail prices, and the added expense of teapots will be repaid—or in practice on the average more

than repaid—by an increase in wages. Most of this excess cost of £200 will therefore be added to the cost of other production of goods and services. Of course it will not stop there. If all butchers or all boot-makers or all lorrymen have their costs increased, they try to put up their prices and make good their loss. If they can do that without fear of competition from outside, we call them sheltered industries. Those that are exposed to outside competition are the unsheltered industries, and they cannot put up the price, but have to stand the extra costs and suffer the loss of consumption—the same loss of consumption which befell the immediate purchasers of top hats in our first example.

Let us consider the unsheltered industries. They are in the first place broadly the export industries. Some exporting industries—sugar and butter and dried fruits—are indeed themselves protected, and receive in effect a heavy subsidy. That subsidy might be increased—e.g. the fixed price of sugar might be raised—so as to relieve them of the excess costs of other protection. But in the short run these industries also have to carry excess costs and suffer a cut in their living standards.

Then there are the industries competing with imports—mostly themselves protected. If imports are actively competing these industries cannot raise their prices, and so they are unsheltered. Like sugar and butter they might be given additional protection, but in the meantime they must bear excess costs. However, at the present time, as we shall see later, most protected industries are working well within the limit of the protection offered by law, so that they also can raise their prices and pass on excess costs. There are important exceptions, but for the most part the protected manufacturing industries are also at present sheltered.

There are also the people who are not producing goods or providing services, but live on fixed incomes from interest. These cannot pass on higher prices, but bear the loss of consumption. These are not numerically very important.

So that we can very broadly regard the export industries as those which bear the excess costs of protection of necessities, and cannot pass them on.

Let us now trace the journey of the excess costs of protecting tea-pots. Some of it will fall at once on export farmers and their farm labourers, whom we agreed to count as one. (I shall refer to them for brevity as farmers, but you will understand in this connection I do not mean sheltered farmers like milk dairymen, who are in an intermediate position, and I include all people working on the farms or stations which produce wool and wheat and other exportable produce, the price of which depends on the world price.)

Some of the first excess cost then falls directly on the farmers, and stays there. Most of the rest goes through higher wages into the costs of sheltered industry, and is passed on through higher prices. Some of these higher prices are paid by the farmer, and he has to carry this dose also. A little may fall on Governments—through railway services, for example—and be carried by the general taxpayers. Some will go into the price of luxury goods, and will rest with the purchaser of those goods. A little will fall on fixed incomes. The rest, which will be the greater part, will fall on the wage-earner in the shape of higher prices for all his necessaries. Retail prices will go up again, and wages follow them, and the higher costs will be passed on again in higher prices, some of which will stick with the farmer, and a little with the taxpayer and fixed incomes. So the process goes on until sheltered industry has entirely got rid of excess costs. Every £100 of excess costs may now be distributed something as follows :

	£
Taxpayers	5
Fixed Incomes	10
Buyers of Luxury Goods .. .	15
Unsheltered Manufacturers .	10
Farmers	60
	—
Total Excess Costs	100

All these elements of the community bear some such share of the excess cost of the protected production of teapots, and suffer a corresponding fall in their living standards. But the burden is very unequally divided. All the community buys the protected teapots, but they do not bear the excess cost, as the buyers of top hats did. Some part of it falls on fixed incomes, and some part on the purchasers of luxury goods having no connection with teapots. This incidence, though it may be unjust to individuals, is not economically harmful. But the greater part falls on the export farmer and his men, who are of very great economic importance to the community at all times. When export prices are high, they may carry a good burden of excess costs without distress; but not during the low prices of the last few years, when much export farming has been unprofitable.*

* The protection of necessaries also will not of necessity affect the balance of external payments. (See footnote, p. 9.) There will be the same repercussions of increased income and employment with teapots as with top-hats, but here they may be partly offset by a decrease of employment and income, mostly in export industry, which will also have their repercussions. The fall in imports will then be partly balanced by a decrease in exports, and for the rest by the increased consumption of imports due to the net increase in employment. Theoretically the decrease in export production and employment might be greater than the increased production of tea-

We have then a large proportion of the cost of protecting necessities falling on unsheltered industries. So far as this is manufacturing industry relief is likely to come either by increased tariff protection or by improved efficiency, for which there is in general plenty of scope. For export industry there is no obvious relief. Costs of production are increased, and some export production becomes unprofitable. It was reckoned in *The Australian Tariff* that relief from tariff costs would be equivalent to adding about 10 per cent. to the price of export produce. The percentage to-day is probably, on the whole, rather less.

I will not stop to discuss the effects which these higher costs have had in restricting export production. In earlier years that question was very important. Under the present conditions of export industry, there would be no substantial expansion at free trade costs. The chief effects of relief from tariff costs would be an increase in land values for the more favoured producers, and some relief to the community from the burden of supporting the less favoured ones. On the other hand, production in the protected export industries would fall away. Sugar production would cease, and in butter and dried fruits, the lower costs would not on the average compensate for the loss of protection, so that the tendency would be towards a lower output.

It is of interest to note that this passing on of costs which leaves most of the burden with the export farmer, occurs equally in Australia when the price of necessities is raised in any other way. When the price of butter is raised sixpence a pound to provide a bounty to dairy farmers, or a home price is imposed on flour or wheat to give a bounty to wheat growers, the added cost is passed on, just as with higher prices due to protection. Most of this assistance given to butter or wheat by means of a home price or "marketing control" is provided in the last resort by the export farmers themselves.

It has been noted above that there are other "necessaries" besides those covered by the retail price index. Anything which enters into the cost of production of goods covered by the retail price index or of export

pots, so that the net increase of employment would be negative. Normally, however, with farm production, which is very rigid—and particularly so in recent years with the marginal farmer supported at public expense—the tendency will be for export production to be maintained. So far as that is achieved by a lowering of the living standard of the farmer (or of the taxpayer), there will be decreased imports. The decrease of imports of teapots will be balanced by the increase of imports due to new employment and its repercussions. The decrease (if any) on account of lower standards of the farmer will give a net fall in imports as a final result, and a consequent improvement to this extent in the trade balance. (Export production, by hypothesis, is not affected.) Generally it is only in so far as the protective policy results in an abnormal restriction of consumption and a consequent lessened demand for imports, that the net result in the short term will be an improvement in the balance of trade.

goods is a "necessary" for our purpose. Under this heading we have many kinds of machinery, farming implements, tools, some fuel, and a good deal of raw material. Protection of these also will give rise to excess costs which will be passed on through wages, and fall in the end mainly on unsheltered industry. The distribution of these costs will be much the same as that suggested in the table above for teapots. There is not, however, a great amount of excess costs due to protection of goods of this kind.

THE PROTECTION OF PRIMARY PRODUCTS.

We come now to the distinction between factory goods and primary products as the subject of protection. For primary products, the incidence of costs is the same as for factory goods—for luxuries on the first purchaser, for necessities mostly on the export farmer. But the benefit—the effect on employment—is very different.

In general, all factories start level in competition. If there are particularly favourable locations as regards climate or transport facilities, all factories can share them. Their costs will depend wholly on their efficiency and the size of their output. In primary production, costs depend mostly on the natural advantages of the farm (or the mine), and with the same efficiency of management vary enormously in different localities. Average yields of wheat vary from 6 bushels per acre to 30 bushels per acre, according to district. Average yields of apples vary from 100 bushels per acre to 500 bushels per acre. The Wheat Commission found that current costs of production (i.e. excluding land values) averaged about 2s. per bushel in the Wimmera, against more than 4s. in the outer Mallee. For factories, then, the whole of the production of a certain class of goods—top hats or teapots—is dependent on the higher price due to protection, and the tariff creates or maintains the whole of the employment in that industry. For farms and mines, on the other hand, it is only the marginal production which is essentially dependent on the tariff, and the employment created or maintained by protection is only a part—it may be a small part—of the total employment in that industry. But all producers get the benefit of the protection, which is therefore, over a large part of the field, an unnecessary bonus, inflating land values. The costs, and their distribution (as we have noted), are the same as for factory products. But the benefit in employment which we get in return for a given cost may be only a half or one-quarter of what would be obtained from the same cost spent in protecting factory products.

To summarize our conclusions:

All protection imposes a cost on the community or some part of it, and the costs of protecting necessities falls mostly on the export farmers. In return for this cost we get the benefit of increased employment, which in normal times means increased population. The lower the rate of protection required the more employment is gained for a given cost, so that it is important to avoid as far as possible industries that require high protection. Protection of primary products gives only a fraction of the additional employment (or population) that is given by protecting factory production. It is therefore in general to be avoided, even when the rate of protection is low. High protection of primary produce is then the maddest of all forms that protection can take. The highest peak of insanity in Australia is reached by the protection of the tobacco industry under a protective duty which in 1934-35 averaged 265 per cent. It is a characteristic and significant feature of the new trade policy recently promulgated from Canberra that this monstrous duty is raised still higher.

It may be noted also that while the cost of protection takes the form of a definite lowering of living standards by a loss of consumption goods, which can reasonably be expressed in £'s, the benefit is primarily and normally an increase in population (or of employed population) on which no monetary value can be put. In times of depression, however, some monetary benefit can be estimated for the relief of unemployment, but this is not an adequate measure of the benefit. In general, protection only makes possible the maintenance of additional population at a given standard—it does not add greatly to existing incomes. The exception is in the protection of primary products where, as we have seen, the greater part of the cost may be taken out, not in greater employment, but in adding to the incomes (and land values) of the more productive farms.

THE TOTAL OF EXCESS COSTS.

Having now discussed the meaning and significance of excess costs, let us turn to the question of their magnitude. The estimate made by the committee for 1926-27 was £36m.,—£26m. on account of factory goods, and £10m. on account of farm production. It still seems probable (as the authors judged at the time) that this estimate, though it could not pretend to high accuracy, was within 10 per cent. of the true figure. In the years that followed, the protective tariff was heightened, and excess costs probably increased. Then came the heavy duties and embargoes imposed by the Scullin Government in 1930-31. These were designed, however, not so much to protect Australian goods as to stop quickly a

flow of imports which we could not pay for. At the same time, they must have had some effect on diverting consumption from imports to Australian products, and this diversion, even without higher duties, means an increase in total excess costs. About 1931, then, excess costs were no doubt relatively higher than in 1926-27, but on account of the greater fall in income and consumption, total excess costs were probably a little lower.

With the depression came a gradual but strong improvement of competitive power by Australian factories, so that even when duties remained unchanged, less protection was used. This came about partly as a result of greater economy and efficiency induced by the depression and the keen competition of Australian factories for the reduced market.

A still more powerful factor was the fall in wages relative to wages abroad. This came about primarily through our peculiar method of adjusting wages to prices. The 10 per cent. additional cut imposed by the Federal Court affected perhaps half the field of wages, but was offset by the slowness of some of the States, particularly New South Wales, to allow wages to be adjusted to lower prices. The net effect over all Australian wages has been a reduction almost exactly equal to the fall in prices. Wages in the three years 1930 to 1932 fell 21 per cent., and retail prices 22 per cent. In England, in the same time, the cost of living fell 15 per cent., and wages only 5 per cent. Wages now in Australia are 18 per cent. lower than in 1930, but in England only 2 per cent. lower. This fall in wages relative to the movement in England took place in the face of a depreciation of the currency in relation to sterling; it may be said at the present time that sterling wages have fallen 34 per cent. in Australia since 1930, and practically not at all in England.

This change in relative wages had, of course, a very great effect on the relative cost of production in the two countries, since wages, directly or indirectly, account for half the costs of factory production in Australia. With the added spur to economy and efficiency given by depression conditions, Australian factories as a whole have moved much nearer free trade conditions. Some important manufactures, such as iron and steel and agricultural implements, can now face world competition without any protection at all, and their prices in Australia are for the most part free trade prices. This movement must have greatly decreased the degree of protection required, and reduced excess costs. This reduction will, however, be in some extent offset by a further diversion from imports to home products, and by the rising level of all consumption. On the whole I think we should expect excess costs in 1932-33 to have been appreciably less than in 1926-27 for manufacturing industry, and to have decreased further to the present time.

The costs of protection of rural industry, on the other hand, which are much more easily measurable, have continued to increase during the last ten years.

These conclusions can be tested by results obtained from inquiries carried out in Adelaide and Perth in response to suggestions made by the Commonwealth Grants Commission. Your Auditor-General, Mr. J. W. Wainwright, is chiefly responsible for the very able investigation of tariff costs in 1932-33, which was presented last year to the Commission. Mr. W. L. Wilson, the Assistant Statistician at Perth, took the leading part in examining the same problem from a different angle on behalf of the Government of Western Australia. (I will for convenience refer to these two inquiries by the names of Mr. Wainwright and Mr. Wilson respectively.)

Mr. Wainwright found for 1932-33 that the excess costs of protected manufactures was about £19m.—£7m. less than the estimate for 1926-27—and for the farm products nearly £11m., or £1m. more than at the earlier date.

Mr. Wainwright's investigation was carried out on similar lines to that of the earlier Committee. Neither was able to attempt a full investigation, but I should judge that Mr. Wainwright's inquiry was at least as thorough as the earlier one. On the other hand the problem is now rather more difficult than it was in 1926-27. At that date most of the protected industries were using the full amount of the protection afforded by the tariff, so that excess costs could be estimated for them with some confidence. The chief difficulty was with industries that were not using the full protection allowed, but perhaps only a half or a quarter of it. This more uncertain field has increased greatly relatively to the more certain field, so that I think Mr. Wainwright's estimate must be liable to at least as much error as the estimate for 1926-27, which was put at 10 per cent. I think, then, we may take excess costs for 1932-33 as being between £27m. and £33m., and since there can be little doubt about the figure for farm protection, the total for factory protection may be taken to be between £16m. and £22m.

Mr. Wilson's results are for the year 1933-34, but they are not directly comparable, because they deal primarily with tariff costs as they affect the State of Western Australia. We shall see presently that some indirect comparison can be made, and that this comparison suggests that Mr. Wainwright's estimate is too high rather than too low.

Let us, however, provisionally take £30m. as the measure of excess costs in 1932-33. The meaning of that is that Australia as a whole is foregoing consumption goods to that value for the sake of additional population and employment. It seems a stupendous cost—hardly credible.

If, however, we estimate the amount of increased population or employment which we get in exchange, the balance seems not unreasonable. The additional population made possible by protection corresponds with the free trade value of protected production.

If we put protected production at £100m. in 1932-33, and excess costs at £30m., then we get a free-trade value of £70m., which might directly support a population at the Australian standard of 900,000, and indirectly nearly three times as many, or certainly over two millions.* On this reasoning, at least a third of our population is only there by virtue of the protection policy, and £30m. does not seem an excessive price to pay. If it was spread uniformly over all consumers, making 5 per cent. all round, and still more if the cost could be distributed in the same way as income tax, the cost would not be very heavy. The trouble is that most tariff costs are on necessities, and so fall with concentrated weight on the export farmer. It is on this account that we have to be very jealous of any increase in tariff costs, and welcome any reduction with very warm appreciation.

The proportion of tariff costs that falls on necessities is therefore a vital consideration. With necessities must be grouped, as we have seen, not only the commodities which enter into the index of retail prices, but all producers' goods used in the production of these commodities. These would include raw material like cotton, wool, etc., and also machinery and plant used in manufacture and transport. The remaining protected goods which do not enter into costs of production, we are calling luxuries.

For 1926-27 the excess costs of protected "luxuries" were estimated at £7m., and the estimate was very conservative. As far as factory goods go, the movement has been towards protection of luxuries, and it may be now that not more than half the excess costs of factory goods are on account of necessities. On the other hand protected farm products are mostly necessities, and excess costs have increased for farm products. On the whole I estimate that a slightly smaller proportion of excess costs falls on the export farmer than in 1926-27, so that there has been some relief on that account, as well as from the reduced total. On the other hand, he has been less able to bear added costs of any kind.

* Against this of course is to be set the increase in export industry possible at lower free-trade costs, with its repercussions. Before the depression, this would have been considerable, though it was judged in *The Australian Tariff* that it would be a good deal less than production dependent on the tariff. Under the recent conditions of export industry, it may for the present be regarded as roughly negligible.

THE STATES AND THE TARIFF.

We come now to the vexed question of the unequal incidence of the tariff among the States. Modern factory industry in all countries tends to concentrate in chosen positions in relation to raw material, coal, power, transport, and markets, and we have a natural concentration here in Victoria and New South Wales. These States therefore receive the benefit of increased population and employment which result from protection of factory goods. On the other hand, the price paid for this increased population falls predominantly on unsheltered industry, which in Australia is mostly export industry.

It happens that all the States are largely interested in export production, so that the burden is widely spread. But some States, Western Australia particularly (and to a less degree South Australia), have a larger proportion of export industry, so that they bear too large a share of the cost, as well as getting too small a share of the benefits. It is clear that South Australia and Western Australia are at a disadvantage in respect to tariff policy.

Is it possible to measure the relative disadvantage? It may be possible to make a reasonable estimate of the distribution of costs amongst States. But can these costs be regarded conversely as subsidies paid to protected production, and distributed as benefits amongst States in proportion to the amount of protected production. The payment of these subsidies makes possible the increased population and employment which is required in the interests of Australia as a whole. But the subsidy may be—in fact should be—entirely used up in making it possible for this new population just to subsist. It cannot be regarded as an addition to existing incomes in the same way that the costs paid are a definite subtraction from the real income of those who pay them. We are essentially comparing a loss of income on the one hand with increased population on the other. The two things cannot be compared in numbers. They are incommensurable. No doubt there are monetary advantages accruing to a State from increased factory employment. In times of depression and great unemployment, they may be very great. In times of full employment they may be comparatively small. At no time are they adequately measured by the amount of subsidy to protected production.

With protection of farm products, a good deal more of the subsidy is a definite increase to existing incomes, as I have pointed out earlier. There is therefore a better case here—but still not a good one—for balancing subsidies against costs.

Estimates of costs and benefits among States have been made on the

lines I have indicated, but I do not think they are valid. I am afraid that I was the first to offend in that way, but it was nearly ten years ago, and I quickly recanted. Mr. Wainwright, in his enquiry, was particularly concerned with the unequal effect of the tariff in States, and has made a calculation on these lines, not perhaps with entire conviction, but for want of a better way.

I will mention his results in a moment. Here I want to say first that I do not think this method of distributing benefits is valid; and secondly, that his distribution of costs according to population could be improved upon. It is fundamental, in the position as I have put it to you, that excess costs fall predominantly on unsheltered industry. A better way would be to distribute one-half of total excess costs in proportion to the value of unsheltered industry in each State, and the other half in proportion to its population.*

I have said that I do not think that "benefits" can be measured crudely by the subsidies to protected production. I want, however, for the moment to assume that they can be, in order to make some comparisons of Mr. Wainwright's results and those of Mr. Wilson's for Western Australia.

If we revise Mr. Wainwright's figures by distributing one-half the costs in proportion to unsheltered export industry and the other half in proportion to population, we get the following results for net gains or losses by States in 1932-33, which we may compare with the original estimate:

	Original £m.	Revised £m.
New South Wales ..	- 1.74	- 1.95
Victoria	+ 1.43	+ 1.82
Queensland	+ 3.28	+ 4.05
South Australia ..	- 1.11	- 1.30
Western Australia ..	- 1.30	- 2.15
Tasmania	- 0.50	- 0.47

The revised estimate increases the loss of South Australia a little and of Western Australia greatly, and leaves Tasmania untouched. This is what we should expect. Western Australia has by far the greatest proportion of unsheltered export production. Much of Tasmanian farm production has a sheltered market, and the State gets great benefits from interstate free trade.

* In protection of necessaries, 75 per cent. of excess costs is taken as falling on unsheltered industry; for luxuries perhaps 20 per cent. Protection of necessaries accounts for about two-thirds of the whole, so that 50 per cent. is a conservative figure for the proportion of total excess costs falling on unsheltered industry.

Now let us look at the Western Australian results. There they tried to get a net measure of the total effects of the tariff for that State alone, by comparing the price of all interstate imports and exports with the price of duty-free goods, and counting the excess price of imports as a loss and the excess price of exports as a gain. They were able to do this because they have a complete record of interstate trade, which no other State has. This result will take into account the extent to which excess costs are passed on to unsheltered industry. It will also take into account any greater cost falling on Western Australia, because interstate freights are higher to that State than to any other from the manufacturing centres of the east. I am not sure that the result should be exactly comparable with that derived from Mr. Wainwright's, but I think it should be at least roughly comparable. Here are the two figures for net effects on Western Australia :

Mr. Wainwright's revised ..	— £2·15m.
Mr. Wilson's	— £1·19m.

Here is a rather serious discrepancy. To what extent can they be harmonized ?

Mr. Wilson's is for 1933-34, and we might expect tariff costs to have fallen a little in the year, but not much. That might account for £100,000 and reduce the difference to, say, £1m.

Mr. Wilson's estimate, however, includes the amount by which factory goods from the east are raised in price by customs duty (including primage) actually paid on raw material and machinery used in production. This is excluded by our definition of excess costs, and is excluded from Mr. Wainwright's estimate. Mr. Wilson's figure will be exaggerated on this account, and the discrepancy increased. I am not at present prepared to offer any estimate of the amount of this error.

On the other hand, Mr. Wilson has left out certain elements of excess costs. Sheltered goods received from other States will be raised in price by the passing on of tariff costs, though by definition the price will not be raised above that of duty-free imports from overseas. I have made a tentative estimate of the error on this account, and make it about £150,000. There is one other respect in which Mr. Wilson's estimate will be low. His comparisons are in general with the price of British goods, and these are not always the potential competitors in the Australian market. Mr. Wainwright's estimates, like those of the earlier enquiry, were based on the average duty paid, and not on the British preferential tariff. If Mr. Wilson had compared Western Australian prices with goods duty-free from the cheapest source, his excess costs would have been increased.

To make his figures comparable in this respect with my revision of Mr. Wainwright's, I would very doubtfully add 10 per cent.

I am afraid we cannot make much of these deplorable confessions of ignorance, but I am inclined to think that if all these corrections were properly made they would not raise Mr. Wilson's figure to more than £1·5m.; and if Mr. Wainwright's is assumed to be 10 per cent. too high (and I know he believes it to be conservative), we still have it over £2m. There is still an unexplained discrepancy to be cleared up.

I am, however, the less concerned to clear it up, because (as I have said above) I do not think that the benefits to States are properly measured by the subsidies to protected production. Even if the two estimates considered above could be made to agree, the harmonized results would have no validity. The "benefit" is primarily an increase of population—a political end which cannot be measured in terms of economics.

THE LOWERING OF TARIFF COSTS.

Let me in conclusion return to the question of the reduction of tariff costs and the prospects of the movement continuing. The strongest argument for protection in general is that it is necessary to support new industries, until they have acquired experience and skill and are able to stand on their own legs. In practice, we have found in the past that this growing-up process has been very protracted—the infant industries have refused to grow up, and have gone on requiring increasing doses of baby food. Some advance was made in the years just before the depression, particularly in consolidating small businesses into larger ones and getting rid of surplus capacity.

With the depression, as we saw earlier (page 17), came a steady reduction in costs, not only absolutely but relatively to the costs in other countries from which our imports were drawn. This greatly improved competitive power is reflected in the reports of the tariff board. For most factory products, the need for protection is found to have become much less in recent years. Even for such highly skilled manufactures as agricultural implements, the question is raised whether they could not and should not be put on the market at prices substantially below free trade prices in return for protection from dumping.

The tariff board has played an important part in this encouraging development. The board offers a remarkable instance of the delegation (in effect) of a highly specialized job to experts, with very satisfactory results. In this business of tariff protection in the interests of the community as a whole, there were in fact no experts ready-made. The

members of the board had to learn their job by doing it. Naturally enough, the board's earliest efforts were crude, and its authority consequently slight. It applied itself, however, diligently and intelligently to its work, studied, gained experience, broadened its outlook, built up a technique, and as a result has become very competent. The consequence has been that it has to a large extent gained the confidence of all the interests concerned, and established its authority.

The present Government has contributed greatly to that end. Its declared policy has been to refer all questions of protection to the tariff board, and to give great weight to its recommendations. That policy has up to the present been carried out in very fair measure, in spite of the obvious political difficulties which it entailed. There have been at times hesitations and postponements, but in the end the tariff board's recommendations have been substantially carried out. It appeared likely that this policy if pursued would give the board a status in public confidence that would be increasingly difficult to upset; so that even a diehard freetrader or protectionist in the Ministerial chair, though he might impede, would find it impracticable entirely to frustrate the board's guidance to a sane and balanced protective economy.

THE NEW TRADE POLICY.

This pious hope has been somewhat rudely dashed by the new trade policy recently promulgated from Canberra. On two most important items of tariff policy (the protection of textiles from Japanese competition, and the protection of motor-car manufacture) the Government has taken drastic action, without, so far as the public has been informed, even referring these highly technical questions to the board. On another item (the increased protection of tobacco), action has been taken directly contrary to the board's findings, without any reason being offered for rejecting them. By this action the Government appears to have undone the good work in the past, to have destroyed the promising building it has been patiently erecting, and to have exposed the whole structure of our tariff policy to the vagaries of future political expediency, and the log-rolling of interested parties.

This aspect of the new trade policy bears directly on my subject to-night. There are other aspects, not so closely related, on which I feel bound to make some comment. This new policy has startled and bewildered a great many people, and particularly the economists. I have no authority to speak for them, but I have no doubt that most of them are as much troubled as myself. It has been a pleasant feature of the years of depression that we have felt ourselves in broad agreement with

the trend of Government policy on economic questions. Now for the first time comes a divergence which most of us will feel very deeply.

The first disturbing feature of the new trade policy is the absence of any rational principle behind it. The need of placating "good customer" countries is put forward as a principle, with Great Britain as the one "good customer" to whose interests all other countries, whether good or bad customers, must be sacrificed. Attempts to balance the trade between two countries are now one of the greatest obstacles to the revival of international trade on which Australia is particularly dependent. Apart from this important consideration, the fundamental assumption of the argument is not supported by the facts. The United States is a "bad customer" country, we are told, because we have a heavy adverse balance of trade with her. The facts are that we have an even heavier adverse balance with Great Britain.

Let us look at the balance of payments for 1934-35. We had £31m. to pay for imports of British goods, and about £26m. for interest, sinking fund, and other services (beyond those included in the valuation of imports). To our credit were about £38m., the value of imports from Australia retained by Great Britain. So the balance sheet for Australia in 1934-35 runs thus:

Cr. Exports	£38m.	Dr. Imports	£31m.
Adverse Balance .	£19m.	Interest, etc. ..	£26m.
Total	£57m.		£57m.

So the year ended in a balance of £19m. against us. We paid about £6m. of this balance with gold, and the remainder (£13m.) had to come out of favourable balances with other countries or London reserves. We should, however, set against this the capital investment from Great Britain, which is not accurately known but may have been of the order of £5m.

If, then, we are going to talk about "good customers", Britain is no doubt, in one sense, a good customer of Australia, but Australia is a much better customer of Great Britain. If we are going to adopt this vicious system of balancing trade between two countries, it is for Britain to buy a great deal more to make the balance even. But in any event trade of different kinds has different values. Other countries must get their wool from us, just as we must get petrol from America, regardless of the other trade between the countries concerned.

Apart from the principles involved, the most dangerous feature of the new policy is the threat to wool, on which our whole economy is based. Japanese imports were already subject to very severe customs duties, and this new savage discrimination against Japan can be expect-

ted to stir national resentment to a frenzied dance, whenever it suits the Japanese authorities to call the tune. I am not so much concerned with any immediate disturbance of the market. That might be very costly to the wool-grower, and disastrous to our balance of payments; but on the other hand, it may not suit Japanese policy to withdraw too quickly from the wool market. It is the long run effect on wool prices which is more certainly to be feared. Wool is faced with the increasing competition of substitutes. If only a quarter of present wool consumption was replaced by other fibres, the effect on prices and on Australia would be disastrous. The wool-growers themselves would be troubled by prices rising much above the level reached this year, because high wool prices encourage the development and use of substitutes, and imperil the future price of wool. But high prices for wool would not be nearly so effective in encouraging substitutes as the passionate national sentiment of a people devoted to taking any and every means to overcome their dependence on wool. That is the prospect before us. Japan was buying wool in large and increasing quantities. She is showing ability to make textiles of wool so cheaply for export as to open up new markets for wool, which neither Great Britain nor Australia could attempt, and so make up, and more than make up, any loss on account of substitutes. This promising development we have nipped in the bud. Further, when Japan has shown the way to a comparative independence of wool, there is a possibility of other countries of a supersensitive nationalism, such as Germany and Italy, following her example. (Flocks suggest Abraham and a non-Aryan taint.) The tragic possibilities are endless. In return, there seems a prospect that Great Britain will buy a little more inferior Australian beef at unprofitable prices in place of the better product of Argentina.

More broadly, looking at the gloomy international situation, one would have expected a conciliatory foreign policy for the next few years, until international relations are improved, or we have at least done something adequate for defence. Two leading features of such a policy would be to enhance in every way our friendly relations with the U.S.A., and to avoid with particular care any action calculated to provoke Japan. Both these important considerations appear to have been deliberately flouted.

I have already referred to the project for making motor car chassis in Australia. This is the most important and difficult application of the protective policy that has ever been attempted in Australia. If ever there was a tariff item which required full public investigation and criticism, it is this. Yet this is the item on which, apparently, departmental advice is regarded as so competent as to make quite superfluous

any reference to the experienced tariff board, until after the Government is committed to the project, and the industry, in fact, has been launched with the support of a heavy tariff and a large bounty.

From every angle, the new trade policy inspires the gloomiest forebodings, and the prospect is the worse, because it seems to have been launched with the mild approval—I was tempted to say, connivance—of all political parties. One can only hope that its operation will be carried out with quietly diminishing vigour until in a year or two it passes into deserved oblivion. Failing that, one can only be reminded of the old Euripidean tag, more familiar in its Latin form:

“Quem Juppiter vult perdere, dementat prius”