



THE UNIVERSITY OF ADELAIDE

Australia's Share in International Recovery

THE JOSEPH FISHER LECTURE
IN COMMERCE

GIVEN IN ADELAIDE

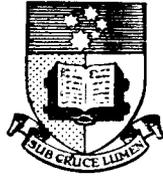
JULY 14, 1932

BY

A. C. DAVIDSON

GENERAL MANAGER, BANK OF NEW SOUTH WALES

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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 fifteenth of the series, was given by A. C. Davidson, Esq., General Manager, Bank of New South Wales.

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

- *1904—"Commercial Education", by Henry Gyles Turner, Esq.
- *1906—"Commercial Character", by L. A. Jessop, Esq.
- 1908—"The Influence of Commerce on Civilization", by J. Currie Elles, Esq.
- *1910—"Banking as a Factor in the Development of Trade and Commerce", by J. Russell French, Esq.
- *1912—"Australian Company Law; and Some Sidelights on Modern Commerce", by H. Y. Braddon, Esq.
- *1914—"Problems of Transportation, and their Relation to Australian Trade and Commerce", by the Hon. D. J. Gordon, M.L.C.
- *1917—"War Finance: Loans, Paper Money, and Taxation", by Professor R. F. Irvine, M.A.
- *1919—"The Humanizing of Commerce and Industry", by Gerald Mussen, Esq.
- 1921—"Currency and Prices in Australia", by Professor D. B. Copland, M.A.
- 1923—"Money, Credit, and Exchange", by J. Russell Butchart.
- *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.).
- 1932—"Australia's Share in International Recovery", by A. C. Davidson, Esq.

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.

The University accepts no responsibility whatever for any facts cited or opinions expressed in any of these lectures.

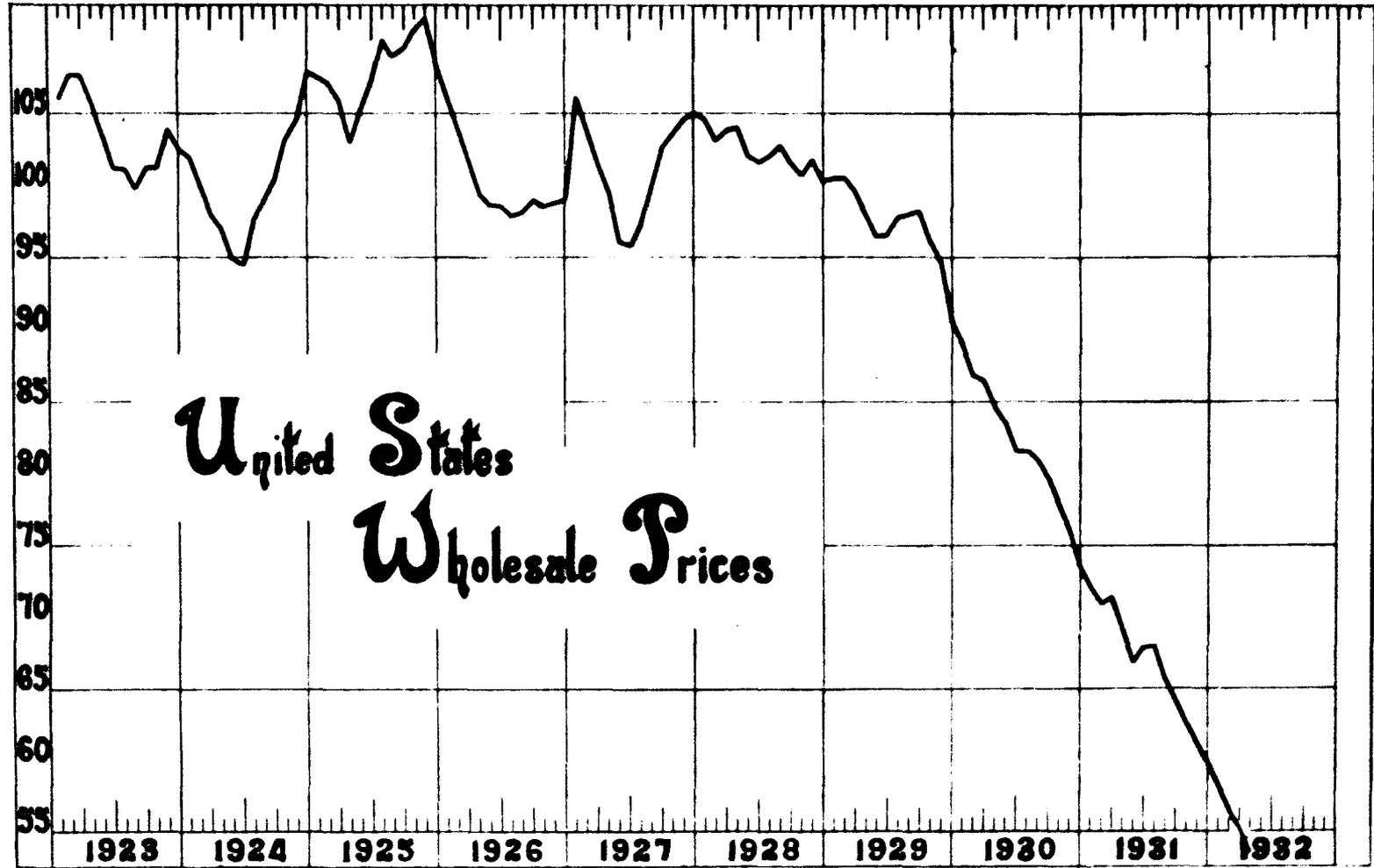
AUSTRALIA'S SHARE IN INTERNATIONAL RECOVERY

Your Excellency, Mr. Chairman, Ladies and Gentlemen,

Having read the list of previous lectures under this Foundation, it is with the greatest diffidence that I address you this evening. Not only must I follow men of high academic distinction. My old chief, Sir John Russell French, during whose tenure of office as General Manager I joined the service of the Bank of New South Wales, delivered the fourth Joseph Fisher Lecture. He spoke in 1910 on the subject, "Banking as a Factor in the Development of Trade and Commerce". Those were halcyon days, when bankers, in common with other Australians, viewed their task as one of assisting in an expansion to which imagination set scarcely any limit. Much has happened since to dispel the mirage of infinite development. We no longer take it for granted that these Southern Dominions live in a happy world of their own, remote from Europe's wars and America's racial hates. Indeed, the remark of my immediate predecessor, Professor T. E. Gregory, that we in Australia had probably never heard of the Wall Street boom because we had one of our own, seems to-day almost savage in its irony. It was a little unkind even when it was uttered in 1930. Your own State of South Australia had emerged from its latest boom long before the middle of 1929, when some in Wall Street were still speculating on a "new era" of permanent prosperity and the rest were speculating on their fellow-speculators.

I would not even concede that Australians outside this State* were unaware in 1929 of what was happening overseas, nor did they miss its immense significance to Australia. It was in January of that year that the last of our long-term loans was raised on the London market. It was in September, 1929, that the Bruce-Page Administration fell in a first attempt to adjust the Australian economy to its changing task. We were early aware that in the absence of easy borrowing we would have to meet our commitments overseas by increased production at lower costs. But the change-over was not easy.

* South Australia.

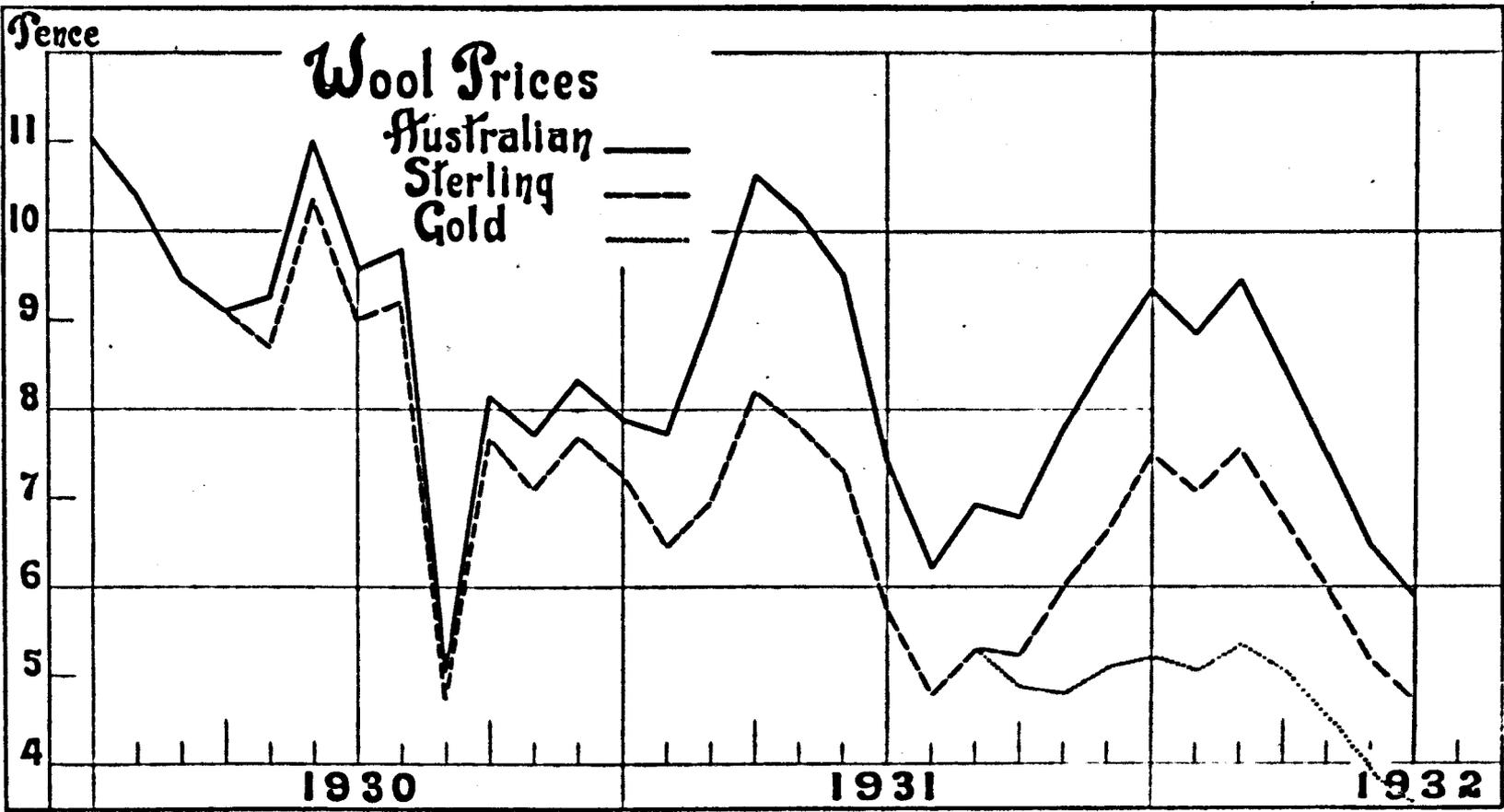


No. 1. AMERICAN WHOLESALe PRICES.

In taking as my subject to-night, "Australia's Share in International Recovery," I shall confine myself to our island story, avoiding any discussion of the causes of the world-wide depression. I do so merely in order to mark out a subject-matter capable of treatment within the time at our disposal. All of us are painfully aware of our dependence on the prosperity and adversity of the big world. We sell in its markets nearly a third of the value of our production, even after reckoning export values at free-trade prices and our home consumption at the prohibitive prices that "protection" inflicts. But as a people we are too small a toad under the harrow of adversity that torments the world to control the forces that draw the harrow. We can but watch its sharp spikes and dodge them as best we may.

In the graph before you (Graph No. I) is depicted the course of American wholesale prices, a convenient record of the change which occurred in 1929 in the trend of the purchasing power of gold, then the international money of the world. From 1923 to the middle of 1929 there was, on balance, a slight sagging in gold prices, but, substantially, the restored and extended gold standard fulfilled the hopes of those who, at Genoa in 1922, recommended its restoration. The essential condition of the satisfactory working of this system was the flow of investment from creditor countries to debtor countries. During the period 1924-1929 inclusive United States investment abroad averaged 1,070 million dollars per annum and Great Britain 118 million pounds sterling per annum. It was when this investment ceased that the system threatened to break down. The international trade facilitated by the gold standard gave until 1929 a reasonable stability in price levels as well as in exchange rates between the moneys that were linked by it. Since then the very opposite has been true. Monetary stability and expanding international trade have given way to shattered prices, discouraged enterprise, and universal unemployment. Gold prices, as you may see by this graph, based on Bradstreet's Index of Wholesale Prices, have fallen in United States dollars, one of the two great currencies still convertible into gold, from a level of 98·3 in September, 1929, to 53·5 in April, 1932. Taking Irving Fisher's Index of Wholesale Prices, the fall between the same dates has been from a level of 98·3 to 62·4. In both instances these are the latest figures available. Steeply falling prices always and inevitably mean unemployment. Buyers hold off, intending to enter the market only when bedrock is reached. Producers fear losses, which, indeed, are all too likely when costs are incurred at one level and goods are sold at a later and lower one.

When, less than two years ago, Professor Gregory delivered the

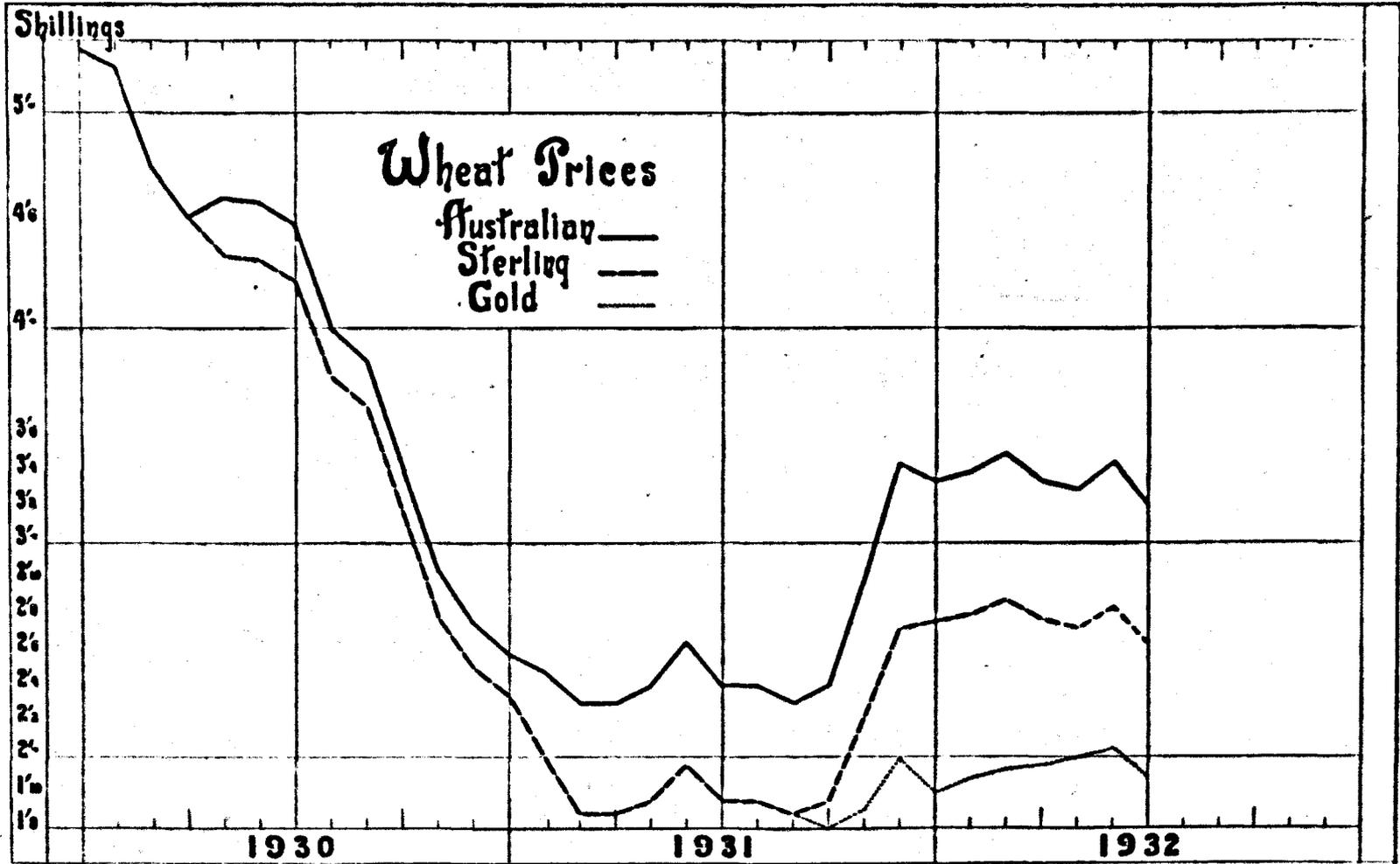


last preceding lecture under this Foundation, he estimated the total number of unemployed all over the world, including Russia, at about ten million persons. "That," he said, "is a part of the problem of price-level at the present time, . . . one of the most serious and difficult of any of the economic problems we have had to face in the lifetime of any man now living". Professor Gregory was then in hopes that prices would be somewhat higher by the end of 1931 than at the end of 1930. They proved to be lower both in gold and in sterling. In fact, gold prices fell a further 18 per cent., and even sterling prices, in spite of the departure from gold, were lower (about 3 per cent.). And the number of unemployed is now at least twice, probably nearly two and a half times what it was in 1930, viz., between twenty and twenty-five millions.

It would take me too far into the field of international economic history to trace in detail the reasons for that disappointing drift. The main reason for it was the financial crisis from June to September of last year. This was an inevitable consequence of the unstable financial and economic position of Central Europe, and was precipitated by the revelation that the big Austrian bank, the Credit Anstalt, was in an insolvent condition, and by the runs on the German banks and on the Bank of England which this set going. The financial crisis deepened the economic crisis by causing almost all nations to redouble their efforts to sell exports and to limit imports, thereby forcing prices still lower and raising fresh barriers to international trade.

Professor Gregory was convinced that the problem of falling prices, "if it is going to be solved at all, must be solved by the agency of central bankers; but I am bound to admit", he added, "that the process of solving this problem is much more heart-breaking than it appears at first sight". The events of the last two years have lent a gloomy emphasis to my learned predecessor's admission. In Australia, however, the intervening years have witnessed a not unsuccessful resistance to what at one time seemed overwhelming odds against us. We have hung on. We have even made some headway, notably in this State.* Men of every political party and of every calling have played their parts in this truly national effort, but I trust you will pardon a banker for claiming first rank for the leaders of his own profession, the Chairman of the Commonwealth Bank Board and the Governor of the Commonwealth Bank. We are not out of the wood, and therefore we owe them still our active support and counsel in the still difficult and doubtful contest.

* South Australia.



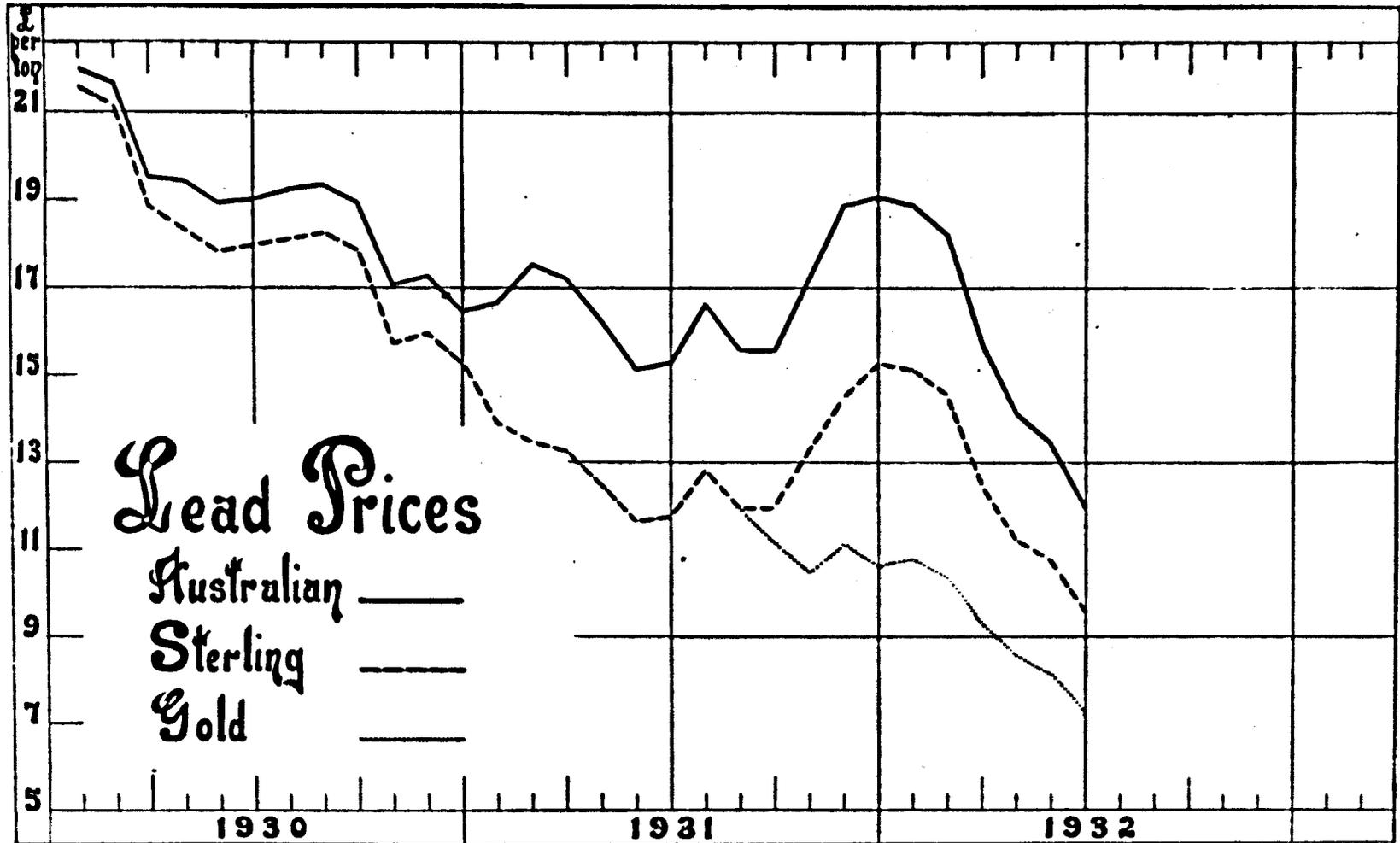
No. III. WHEAT PRICES, showing divergencies of gold, sterling, and Australian prices.

For two reasons the initial impact of the collapse in prices was more severe upon our Australian economy than on almost any other. To one of these reasons I have alluded already. The depression made an end, for a time at least, of our public credit as borrowers overseas. We had thus to make a sudden right-about-turn. Instead of borrowing some £30,000,000 a year, a sum roughly offsetting the annual interest owing on all earlier loans, we were called upon to meet that interest burden by a surplus of exports over imports. To make that transition feasible under conditions of individual production and trading, we needed a change in the relation of costs to prices sharp enough to attract substantial numbers out of capital construction-trades into the production of additional exports or of consumption goods that would supplant imports. Capital construction-trades may be taken to be trades which produce "buildings, factories, machines, equipment for transport and public-utility enterprises and the like." For the major part of our economic activity we are still organized on individualistic lines. Only under the attraction of a wider margin of profits in the appropriate industries could the re-shaping of our national economy be achieved.

The other reason which made the collapse in gold prices more severe in Australia than elsewhere was the especial severity of the fall in the prices of wool, wheat and base metals, our principal exports. (See Graphs Nos. II, III, and IV). Professor Melville, whose accuracy and industry in statistical work is not unknown to you, has reckoned the fall in the gold prices of our exports since 1926-27 at no less than 68 per cent., and I understand that Professor Giblin, the Acting Commonwealth Statistician, confirms that calculation. Very evidently heroic measures were needed to prevent the collapse of our whole economic structure under such a bludgeoning by Fortune. We have taken heroic measures and we have held on. Only just held on, it may be. What more could be expected while the world depression was deepening? World gold prices of our exports have fallen nearly a third since the Premiers' Plan* was drawn up. Yet as a nation we are entitled to draw from a retrospect of what we have achieved courage to continue the fight.

The first aim of the Premiers' Plan was to preserve the credit of all the Australian governments. This was done by concerted economy in expenditure on wages, salaries, pensions and interest, and by increased taxation. But for these measures deficits in all the States would have mounted up as did that of New South Wales when the Lang Government evaded its part of the task. Uncontrolled deficits

* 10th June, 1931.

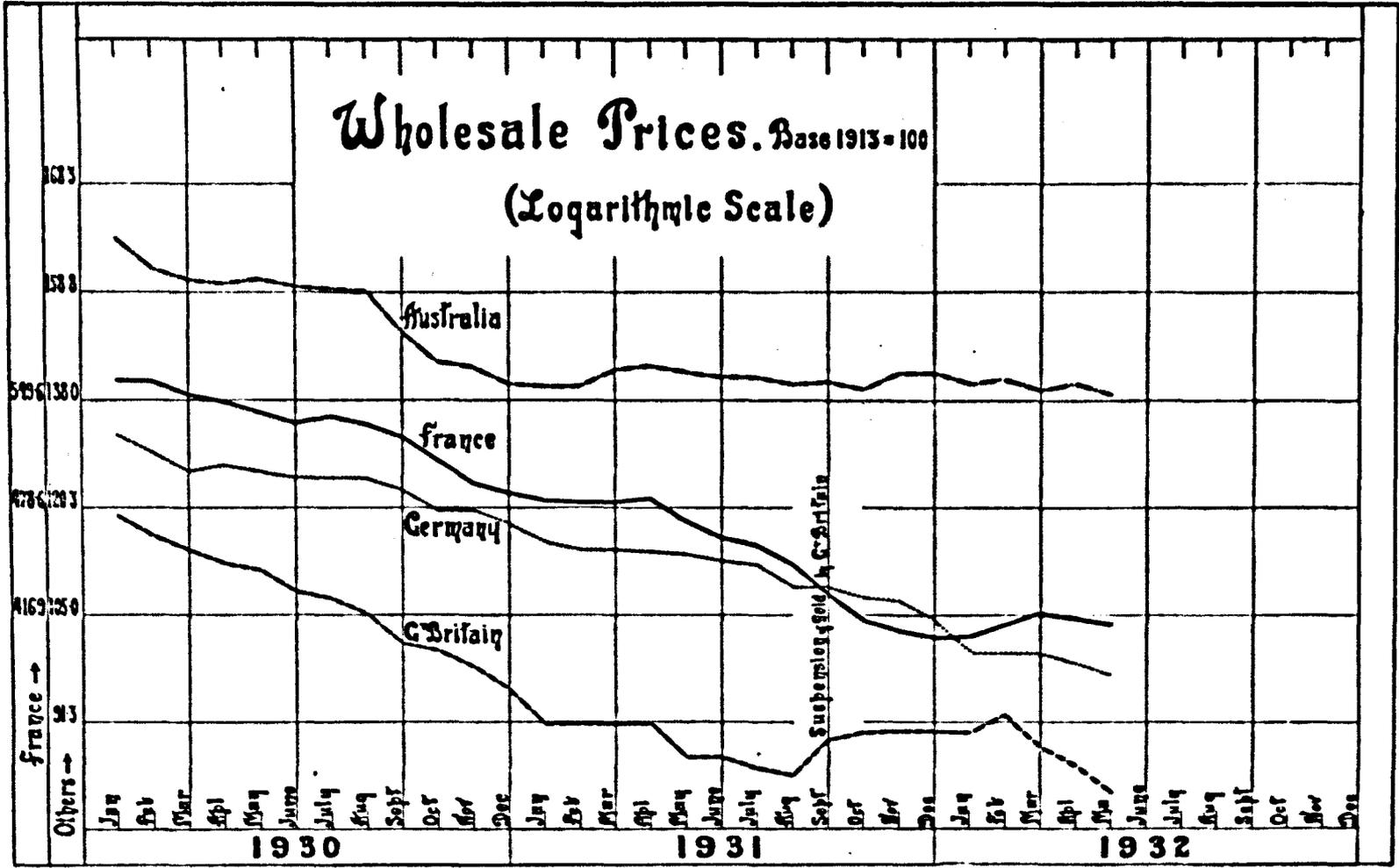


No. IV. LEAD PRICES, showing divergencies of gold, sterling, and Australian prices, selected as typical of the movements in prices of base metals.

would have caused a flight of capital and a collapse in the value of securities of all kinds, endangering the whole financial structure and all the savings of the Australian people.

But the Premiers' Plan, as I need hardly remind an Adelaide audience, went beyond the problem of government finance. It dovetailed with other measures set on foot earlier in 1931 to reduce costs throughout the Australian economy. The imperative need of reduction in costs stood out from the figures that I quoted as to falling overseas prices and from our inability to raise those prices. If production and employment were to continue even to the degree that remained after the first slump in 1929-30, a margin or hope of profit had to be left to the producers of exportable goods. In January, 1931, the Commonwealth Court of Arbitration had given a lead to all our wage-fixing tribunals by reducing the wages covered by its awards by ten per cent. over and above the cost-of-living adjustment of the basic wage. Equity suggested that this cut in real wages should be balanced by corresponding reductions in interest and in rents. But it is obviously dangerous to break into contracts save under the clearest mandate of national necessity. Perhaps the highest merit of the Premiers' Plan is that it succeeded in this difficult task, co-ordinating action by the banks, other financial institutions and private creditors to effect these reductions and that in the result it strengthened rather than injured the confidence of investors in Australia. Not without legislative pressure but mainly by voluntary action interest rates have been reduced on an average by well over 20 per cent.

Even so, had wages and salaries, interest and rentals been cut by twenty per cent., and nothing else done, the adjustment of Australian costs would not have restored a margin, nor even a hope of profit to the exporting industries. The reductions directly made were supplemented, fortunately, by an indirect reduction universally and smoothly achieved by the fall, between October, 1930, and January, 1931, in the exchange value of the Australian pound. This meant that all Australian prices were re-stated in a unit of smaller and, incidentally, of more stable purchasing power than the pound sterling. Reference to Graph No. V (Wholesale Prices) shows that the wholesale price level in Australia since January, 1931, has been relatively stable during a period of acute decline in all other wholesale price levels. The fall in the exchange value of the Australian pound made no direct increase in the national income. It merely translated the sterling incomes of exporters into more numerous Australian units and in so doing redistributed the real income of



No. V. WHOLESALE PRICES.

local products and imports somewhat more favourably to exporters, somewhat less favourably to sheltered industry and to consumers and taxpayers generally. Indirectly, however, the fall in the exchange value of the Australian pound did increase the national income. It maintained production at record volume in the all-important industries, thereby preventing the appalling increase of unemployment throughout the community that would have followed the collapse of the wheat-growing and the grazing industries. Collapse is by no means too strong a word for the position into which rural production would have been forced had wheat and wool continued to fetch prices at the Australian seaboard as low as their gold or even sterling prices. (See Graphs Nos. II and III).

WORLD PRICES OF AUSTRALIAN EXPORTS, 1929-32.

	Sterling and Gold. March, 1929.	Sterling. May, 1932.	Gold. May, 1932.
Wool	16·67 pence per lb.	5·18 pence per lb.	3·92 pence per lb.
Wheat	*5s. 3½d. per bushel	2s. 8d. per bushel	2s. per bushel
Lead	£25 10s. per ton	£10 15s. 5d. per ton	£8 3s. per ton
Zinc	£27 3s. 6d. per ton	£12 11s. 1d. per ton	£9 10s. per ton

* Wheat figures for December, 1929.

It is true that Australia has been faced with serious budget deficits in the past three years. Thanks to the Premiers' Plan these were brought under control. They have been financed by short-term Treasury Bills discounted by the Commonwealth Bank. To make these Treasury Bills a negotiable money market security which can be dealt in by the trading banks the Commonwealth Bank has undertaken to re-discount them at all times should the ordinary business requirements of a trading bank make such desirable. This arrangement makes it possible for the trading banks to take quantities of these Treasury Bills off the hands of the Commonwealth Bank as their liquid funds become available for such forms of investment. The effect of this type of finance, provided it is rigidly controlled and budget equilibrium is in sight, is to increase both the liquid reserves and deposits of the banks and to sustain internal prices. The changes in the cash position of the Banks during the past two years are worthy of mention. The first column in the table below shows the effect of Treasury Bill finance. The second column shows firstly the effect of the transfer of the gold of the trading banks to the Commonwealth Bank acting as the Central Reserve Bank for Australia, and secondly that the Banks are using their balances at the Commonwealth Bank to supplement their holdings of Australian notes

in place of their holdings of coin and bullion as was done previously. In a time of depression we should expect to find a considerable shrinkage of the total deposits of the trading banks. That deposits have increased during the last nine months is due largely to Treasury Bill finance.

CASH POSITION OF THE TRADING BANKS.

Quarter.	Balances due by Commonwealth Bank to Trading Banks. £m.	Coin and Bullion. £m.	Austra- lian Notes. £m.	Total Cash. £m.	Total Deposits. £m.	Ratio of Cash to Deposits. %
1929.						
Decr.	8.4	21.3	13.0	42.8	277.6	15.4
1930.						
March	13.5	14.6	14.4	42.5	274.7	15.5
June	16.9	4.6	16.0	37.6	268.6	14.0
Sept.	15.7	2.7	17.4	35.8	262.5	13.6
Decr.	20.8	2.1	16.8	39.8	263.4	15.1
1931.						
March	29.7	2.1	17.1	48.9	263.3	18.6
June	32.2	2.0	18.9	53.1	259.9	20.4
Sept.	23.0	2.0	20.3	45.3	255.8	17.7
Decr..	22.2	2.1	18.6	43.0	268.5	16.0
1932.						
March	32.1	2.2	18.9	53.2	282.3	18.8

That these measures have resulted in an enlightened banking policy in Australia is confirmed in a statement made by no less an authority than Professor T. E. Gregory. Writing in the Royal Bank of Canada's Circular of October, 1931, he remarked:—"The efforts of the politicians must be seconded by the central banks—a concerted effort must be made (primarily through the financing of budgetary deficits through central bank credit) to cause a rise of prices."

Equilibrium, in the sense of a balance of prices and costs which admits of continued exchange between various commodities and services is the very essence of economy. To restore it is to restore purchasing power. Every approach to such a balance of prices maintains employment in the sense that it slows up the decline in spending power that goes with losses. In this way the three Australian adjustments to which I have referred, all made in 1931, viz. (i) Wages and salary reductions, (ii) Interest and rental reductions, and (iii) the fall in the exchange value of our pound, made up a well co-ordinated plan to restore industry and employment.

They were favoured and eked out by the luck of two excellent

seasons in succession, taking the Commonwealth as a whole. Wheat, wool, and butter—products the volume of which is markedly affected by drought—make up 70 per cent. of our exports. In the twelve years after the war there were five good wheat years, three under average, and four decidedly bad. In wool production three of the last ten years were good, five poor, and two bad. I am generalizing for Australia as a whole. In butter production only one year prior to 1930, viz., 1924, saw a volume of output comparable to those of the last two years. They say in New South Wales that you may expect one good, one fair, and one bad year in three. Both 1930 and 1931 were, on the whole, excellent seasons. But such luck cannot continue indefinitely, and an average season would cut a fifth off our volume of exports, a bad season two-fifths or more.

Far be it from me to minimize the degree of success achieved by Australians in adjusting our economy to the apparently hopeless task that faced us in 1930. Let me rather emphasize again what we were called upon to do and the big thing we have done. For these three tables I am indebted to the Acting Commonwealth Statistician, Professor Giblin. From 1923 to 1929 the balance of our annual payments was roughly this:

1923-29 Average yearly.

	£m. gold.		£m. gold.
Imports	151	Exports	147
Interest and Sinking Fund	26	Loans	27
		"Deficiency"	3
	<hr/>		<hr/>
	177		177

The deficiency was probably covered by imports of private capital.

The onset of the depression created this prospect for 1931-32, if we had gone on as from 1923 to 1929:

1931-32 Hypothetical.

	£m. gold.		£m. gold.
Imports (at 1923-29 volume)	83	Exports (at 1923-29 volume)	48
Interest and Sinking Fund	30	Loans	0
		"Deficiency"	65
	<hr/>		<hr/>
	113		113

To maintain our position as in pre-slump years we should have needed, therefore, an added £65,000,000 of exports (i.e. a total of two and a third times the old volume). To the extent that we failed in that impossibility, we had to make some equivalent adjustment by

reduced imports or reduced oversea payments. It seems an incredibly difficult undertaking to achieve against such odds a favourable balance of payments, but it has been done. This is our actual tally for 1931-32:

1931-32 Actual.							
		£m. gold.			£m. gold.		
Imports	36	Exports	64
Interest	21				
"Surplus"	7				
			64				64

Dividends to oversea shareholders and payments for services, such as shipping and insurance, must come off the "Surplus," leaving perhaps an addition to London balances of £4,000,000 gold on income account. It would be foolish to minimize that achievement, but we must not claim that it has been done by hard work alone. Reduction of imports has accounted for £47,000,000 (gold prices) out of the improvement of £72,000,000 in the actual as compared with the hypothetical position. (From a deficiency of £65,000,000 to a surplus of £7,000,000). That cut in imports has been largely at the expense of Britain, lessening her market here. An increase in the volume of exports, by one third, has added a more constructive £16,000,000 at gold prices. Britain's depreciation of sterling has reduced the cost to us of interest payments overseas by about £6,000,000 in terms of gold. Her postponement of interest and sinking fund on the war debt has let us off another £4,000,000 at gold prices.

Taken by and large, the change-over is an astonishing achievement. But foresight and experience join in warning us that it is as yet a precarious one. The most highly regarded statistical service in Britain, published by the London and Cambridge Economic Service on April 20, 1932, sums up the general business position there as one of "continued and perhaps accentuated world-wide depression, in which the only favourable features are the improving financial positions of Australia and India." Considering how we stood two years ago, our position certainly has improved. But we shall need, I submit, to fight to maintain that improvement. Yet we may draw courage from the fact that we have learnt to use the weapons at our disposal.

In sizing up the further action needed in Australia it will help if we recall the atmosphere in which the Premiers' Plan was adopted in June last year. During March, April, and May, 1931, the fall in world prices had slackened and ceased. Hopes were entertained of a settlement of Europe's political tangle over reparations and war

debts. The long-expected recovery in prices seemed close at hand. There was thus the fullest justification for the reluctance of the Premiers to impose on the Australian people any sacrifice heavier than that needed to hold the fort until oversea prices rose. Unhappily the hopes then held were disappointed. President Hoover's bold move towards a settlement of reparations and war debts was frustrated by indecision and delay. Financial crises followed in Austria, Germany, and Britain. The prices of our exports, after a short-lived rise in October and November, have tumbled afresh. Even so the Premiers' Plan succeeded remarkably in restoring the public credit of Australia and in checking the growth of unemployment. Under more favourable auspices it is plain that it would have put us well on the road to recovery.

Our present position is, I suggest, precarious. The trend of sterling, as well as of gold prices, has been again sharply downwards, and we cannot count on the indefinite continuance of the run of good seasons and exports at new record volumes year after year. The pending stabilization of sterling at a low rate at some future date, the decline in money rates in London, the recent central bank policy of America, and the remarkable success of the British Conversion Loan offer some hope that this downward trend of prices is coming to an end. But the recovery required to place Australian export production on a sound basis is so great that we cannot hope for immediate relief from this source. A mediocre season would work havoc among the marginal wheat farmers and pastoralists, who have hung on at the cost of some deterioration in their properties and of growing indebtedness. Nor is there wanting evidence of the decline of profits in all businesses. The severity of the depression in our main industries would lead one to expect this.

Of the 266 Australian companies whose profits and losses for 1929, 1930, and 1931 were collated recently by my friend, Mr. A. E. Heath, of Sydney, only 8 showed losses in 1929. In 1930, 20 showed losses, and in 1931 some 83 did so. In 1929 these 266 companies, belonging to all the chief cities in Australia, and including many of its leading commercial and financial houses, declared a total profit of £16,775,264. In 1930 the corresponding figure was £13,807,941, and in 1931 it was £7,023,501. There is probably no one in this room who has not instantly reflected that for 1932 the position disclosed in the published accounts will be worse. And while I have been saying that you have been thinking that not all the leeway will be disclosed.

Another effort is therefore needed to stop the rot, to restore the hope and chance of profit throughout Australia, and thereby to sus-

tain the very creditable effort we have made and are making. The Premiers' Plan of June, 1931, so far succeeded that it paved the way.

The new effort which will be shaped at the present or at subsequent conferences of the Premiers may be expected to broaden and straighten out that way. But the events overseas since June, 1931, have warned us against too heavy a use of the method of reduction, of forcing down. To bring and to keep Australian costs below prices that are continually falling would require continual cuts in wages and in interest. Such a process would condemn business to the depressing prospect of further falls in prices. As costs fell the desperate competition to maintain turnovers would mean further price reductions and further cost-of-living adjustments. The result would be a vicious spiral into abysmal and indefinitely prolonged depression. For employment cannot revive so long as every enterprise must face the sale of its products at price-levels constantly undermined by further cuts.

There are evident reasons, partly of a budgetary origin, partly in relief of rural costs, for the rounding out in all States and industries of the reductions already made in interest and wages. But if we attempt to rely on deflationary measures alone to restore equilibrium we shall run grave risks of a financial crisis in Australia similar to that which occurred last year in Austria, Germany, and Britain, and has been avoided only with great difficulty in the United States. Indeed, a crisis in America has been averted only by the reversal of central bank policy through the action of the Federal Reserve Banks in buying large quantities of securities, and thus increasing the cash reserves and reducing the indebtedness of all member banks. Even this action has had to be supplemented by legislation creating special institutions to provide additional relief to weak banks and other institutions. A halving of prices means rather more than a halving of values. Financial institutions are borrowers as well as lenders. As their securities shrank in value so would their solvency. Not even the strongest of them could regard as wise a policy which forced the weakest to the wall.

Sir Wallace Bruce's committee of business men and economists showed, therefore, sound foresight in recommending that a limit should be put to the fall in wages and prices. They held that this could be done simultaneously with the rounding-out of wage reductions in New South Wales and of interest reductions throughout industry by setting in operation a force tending in itself to raise prices. That force has been tried and tested in Australia under conditions of confidence less favourable than those now ruling. I refer to the raising of the rate of exchange. If used in a measure

and degree calculated to offset the price-dropping effect of wage and other reductions it would give us in Australia what we so urgently need as a basis for renewed investment and the employment it would bring, namely, a cessation in the fall of prices.

Interest is still falling, and will, I believe, continue for a time to do so if lenders continue to repose faith in the future of Australian industry. To ensure this a return of conditions that will admit of profit is essential. As interest rates fall under the pressure of a plethora of capital seeking security, we may look for an equitable balancing of reductions in labour costs and in fixed charges. But we cannot afford to wait indefinitely upon the grinding pressure of blind forces. We need very urgently the restoration of a stable equilibrium between prices and costs generally. Within our own economy a very considerable measure of adjustment can be made with safety under the monetary conditions that our struggle to pay our way has created.

We may well regard an independent paper currency as less desirable in many ways than a currency linked by a stable par of exchange with an international gold standard. But we were forced off the gold standard in November, 1929. Sterling, the mother currency, to which our own is linked by strong though elastic ties, was forced apart from gold in September, 1931. Being in possession of an independent paper currency, we shall do wisely to use the power that it confers of "adjusting the exchange to the level of costs." The phrase is Professor Gregory's, and I call him to witness to the merits of exchange management in a crisis like the present. In his latest book, written in November last, on "The Gold Standard and its Future", he argues for an ultimate return by Britain to gold at a devalued par. In the course of his argument he gives his considered judgment that, while a paper standard is in use, "the process by which, in the event of maladjustment, the position is corrected interferes less with the pecuniary status of individuals, and gives rise, therefore, to a smaller degree of social friction than is the case with a fixed exchange when the necessity for a downward revision of the scale of money incomes and fixed charges makes itself felt".

Candour and caution alike bid me underline Professor Gregory's warning that "the superior merit", in this regard, "of the paper exchange must not be overstressed". We in Australia have all along refused to rely on it alone. But, again quoting Professor Gregory (page 84), "it remains true that the method of adaptation which the paper standard permits is well adapted to the exigencies of a complicated society, in which changes in the general scale of money incomes in a downward direction are bound to be very unpopular".

At the moment Australia has the opportunity to restore a profitable basis to industry and investment by the middle way recommended by Sir Wallace Bruce's Special Committee. This includes action along three lines:

(1) The completion of the cuts in interest and wages contemplated and assumed in the Premiers' Plan of June, 1931;

(2) A drive for efficiency in all industries, enforced upon the protected secondary industries by a downward revision of the tariff; and

(3) The prevention of a fall in prices consequent on these measures by an upward movement of the rate of exchange under the control of the Commonwealth Bank.

For the successful operation of this policy certain conditions precedent may be stated: (i) It is highly desirable that the Commonwealth Bank, as the central reserve bank of the nation, should be in command of a large fund of London money, as a means of deterring speculators and of ensuring the accurate adjustment of the rate to the purpose of a stable economic equilibrium in Australia. (ii) It is imperative that the autonomy of the Commonwealth Bank, as an institution seeking simply and solely the welfare of the whole nation, should be respected and safeguarded in every way. (iii) It is equally necessary that the Commonwealth Government should stand behind the central reserve bank and relieve it from the fear of loss or the hope of gain as a result of its activity in managing the exchange.

The second and third of these conditions precedent are matters within the decision of our financial and political leaders. The first is an economic condition, and is therefore not wholly within the control of the human will. At the moment, and probably for nine months to come, the Commonwealth Bank has within its reach the power to build up such a London reserve. In the event of reasonably good seasons it may by wise action extend that power further into the future. But in order to do so the profitable character of production and industry, without which an individualistic economy slows up and ceases to function, must first be restored. This calls for higher efficiency, of course. But the costs of the efficient producer may be stated in terms of an appreciating unit of money or in a stable unit of money. To appreciate a monetary unit is to increase its value, or purchasing power. This is the same as saying that it lowers the general commodity price level. With falling or stable world prices at a low level, the value of the Australian monetary unit is appreciated by reducing the exchange rate on London. This means that

the returns in Australian currency for our exports are reduced, the burden of costs of the exporting industries is increased, and their capacity to maintain and expand production weakened. As the whole Australian community is dependent upon these industries, it necessarily weakens the economic structure of Australia, both public and private, and asset values cannot resist the downward pressure.

Australia, Britain, and the Argentine have made a better showing than any other countries during this depression, largely because their price-levels have been more stable than those of the countries faithful to gold (Graph No. V, Wholesale Prices). The suggestion which I am supporting is that we should follow up that hint as to the way out. To seek a more profitable basis for Australian industry by reductions alone would condemn us to falling prices, insolvencies, further forced conversion of the internal debt, and an all-round writing-down of obligations. The end would be chaos. Industry and investment would remain paralyzed. The time-lag of costs above falling prices would mock each successive cut. The first mediocre season would find the Commonwealth Bank in a vulnerable position. Its London balances would shrink. The buying pressure on the rate of exchange would drive it, in the absence of an exchange stabilization reserve, to uncontrollable levels. If attempts were made to stop the rise by further arbitrary restrictions on imports and exports these measures would aggravate the collapse of the chief industries of the country. Import restrictions would further raise their costs. Export restraints would hold down their returns from sales overseas. The effect aimed at by restrictions is defeated by the loss of confidence and increased panic which they engender.

It is not the rôle of a central reserve bank to stand by consenting to the destruction of the economic life it exists to guard. In contrast with so suicidal a policy the extension of the Premiers' Plan suggested by the Special Committee would encourage exports while the seasons are still favourable. In so doing it would build up the power of the Commonwealth Bank to control the exchange rate and the future stability of our economy.

The spirit of the doleful post-war period has been one of strident nationalism. If the policy under discussion were aimed merely at the stimulation of exports from Australia it would carry the seeds of its own destruction by hostile tariffs or other market restrictions. The necessary counterpart of progressive Australian development of Australian resources is therefore continued activity in international trade. To sell our exports we must find, as we have found hitherto, willing buyers overseas. At this point, therefore, I must remind

you that my subject is "Australia's Share in International Recovery". If we are to recover our internal balance we must adopt policies that, as a whole, chime in with the efforts of others overseas.

Taken by itself, a policy of maintaining and increasing Australian exports would, like the departure of Britain from the gold standard, accentuate the competition for a shrinking volume of international trade. It may be true, as the "Westminster Bank Review" for May of this year confesses, that "British policy, in any new and difficult set of conditions to which the lessons of the past afford little guidance, is normally based upon inspired opportunism in the light of progressive experience". In other words, we like to "muddle through". But the chaotic state into which the industry, trade, and finance of the whole world have been thrown by post-war muddling, from Versailles onwards, should give us pause. This is a time for the application of first principles in the criticism of every step proposed.

The greatest emphasis should therefore be laid on a section of the Special Committee's report which has hitherto received very little notice. I refer to section 55, and, with your approval, I shall read it *in extenso*:

"To some small extent Australia may help to raise world prices. She is part of the world economy, and any action reviving her prosperity accelerates that of the rest of the world. In particular, she can assist herself and the rest of the world by negotiating treaties with other countries for mutual reductions in tariffs. In addition to the probability of improved terms of trade within the Empire, as a result of the Ottawa Conference, it is common knowledge that the Governments of important European countries are at this moment ready to respond to overtures from Australia for reciprocal treaties. The removal of barriers to trade and international investment offers the most hopeful way out of the depression."

If we are to continue to sell overseas an increasing proportion of the products of a prosperous Australia, we must so reshape our fiscal policy as gradually to restore the market here for British and other imports. In this there need be no menace for the efficient secondary industries we have built up in Australia. The world is entering upon a period of planned reconstruction of industry and trade. Few countries have made a more auspicious entry into that era than our own, and, as I see it, the task of our representatives at Ottawa and at later conferences will be to pave the way for policies both in currency and in trade which will dovetail together the interests of the Dominions and Great Britain in the mutual service of a freer trade.