

Australia's Financial Illness—And The Remedy

COMPLETE REPORT OF ECONOMIC EXPERTS

Review of Governments' Finances

SUGGESTIONS PREMIERS ARE CONSIDERING

The report which the committee of economists (Professors Copland, Melville, Giblin, and Shann) and Under-Treasurers presented to the sub-committee of the Loan Council last week is published in detail, for the first time, below.

The report, after a survey of the estimated budgetary position of the Government for the years 1931-32 to 1933-34, explores all possible avenues for economies and reductions of charges against revenue, and makes the suggestions which the Premiers' Conference is now in process of considering.

I.—THE MAGNITUDE OF THE DEFICITS

1. The Committee had before it estimates of revenue and expenditure supplied by the Treasurers of the Commonwealth and all States except New South Wales. For that State estimates were supplied by Treasury officers. The total estimated deficit for the Commonwealth and the States for the current year is £31,140,000.

2. Though estimates of expenditure and revenue were available for each of the years 1931-32 to 1933-34, the Committee thought it sufficient to make a careful estimate of the budgetary position in 1931-32, and to base proposals for the balancing of Budgets on the results so obtained. The figures supplied for 1932-33 and 1933-34 under existing conditions showed no appreciable improvement. The estimate for 1931-32 assumes:—

- (a) No long term borrowing in London.
- (b) No general reduction in rates of interest.
- (c) No appreciable improvement in commodity price levels.
- (d) No radical change in internal monetary policy.

On this estimate the Committee thus assumed the continuance of the present depressed conditions of trade and industry. Later it considered the effects of some changes in these basic conditions.

3. Except for certain duplications the estimates of expenditure and revenue for 1931-32 made by the Commonwealth and State Treasurers were accepted. Expenditure allowed for proposed further economies, but receipts that depended upon new legislation were deducted from revenue, notably the proposed Federal tax on interest estimated to bring in £3,500,000. The results for each State and the Commonwealth are given in column (iii) of Table I. On this basis the total deficits for 1931-32 are estimated in round figures at £39,000,000. In reviewing the estimates of the decline in revenue for 1931-32 the Committee noted some apparent differences in the allowances made for the effects of the decline in national income upon revenue. It is possible that the estimated revenue may not in all cases be reached, and in view of this the estimated deficit for 1931-32 may be £2,000,000 in excess of £39,000,000. The position for each of the years 1929-30, 1930-31, and 1931-32 is shown in the following table:—

Table I.

Deficits of Australian Governments (In £ Millions)

	1929-30 Actual.	1930-31 Estimated by Treasurer.	1931-32 Estimated by Treasurer.
Commonwealth	1.50	13.40	18.40
New South Wales	5.57	10.41	11.51
Victoria	1.17	2.60	3.08
Queensland	.72	.74	1.03
South Australia	1.63	2.20	2.40
Western Australia	.52	1.52	1.85
Tasmania	.02	.21	.22
Total	11.13	31.14	39.08

4. The substantial increase in the estimated deficits for 1931-32 emphasizes the gravity of the financial condition of every Government in the Commonwealth. A continuing and increasing deficit of such magnitude is a menace to all sections of the community. Common interest, therefore, calls for drastic measures to prevent public default and general insolvency.

11. The total expenditure of Commonwealth and States on the items under consideration was £98,000,000 in 1929-30. A reduction of 20 per cent. would give savings of £20,000,000. Two of the States (South Australia and Western Australia) actually show for 1931-32 economies amounting to 20 per cent. of their expenditure on these items. Further reductions of expenditure in the four other States and the Commonwealth to achieve this scale of economy make £8,900,000. This is the amount of additional saving that could be effected in 1931-32 by the general application of the standard.

12. A rough check may be made of the further reductions in expenditure, possible on the basis of a 20 per cent. cut in salaries and wages below the 1929-30 level. The total of salaries and wages in the Government service was about £60,000,000 in 1929-30. An all-round cut of 20 per cent. would give £12,000,000, apart from reduction of staff, which naturally follows the decrease in business of the Railways and Post-office. The data for reduction in rates of pay provided for in the 1931-32 forecast are not complete, but it is certain that the average fall is less than 10 per cent., making £6,000,000 out of the possible £12,000,000. There is, therefore, a further reduction of £6,000,000 to be obtained simply by the cut in wage and salary rates, apart from the smaller staff, and the reductions due to smaller quantities of material used and the lower price paid for it. It is clear that the total reduction of expenditure would be at least the £8,900,000 set down in paragraph 11.

13. The remaining big item of expenditure is pensions, made up of invalid and old-age pensions, and war pensions, with which may be grouped the maternity allowance. When wages generally are down 20 per cent. and salaries and wages in the Public Service are down with them, it is but reasonable that all these pensions should suffer the same cut. Most of this reduction is balanced by the fall in prices, and so is only nominal. Prices in the first quarter of 1931 were 15 per cent. lower than in 1929 or in 1931, so that 20 per cent. off the nominal value of a pension would reduce its purchasing power very little below what it was in those years. Even with this reduction Australian expenditure on pensions would be much more liberal than in Canada or New Zealand. This is clearly shown in the following statement:—

Expenditure per Head of Population on Invalid and Old-age Pensions and War Pensions

	Invalid and Old-age Pensions.		War Pensions.	
	£	s. d.	£	s. d.
Australia (1930-31)	1	15 2	1	4 8
Australia (with 20 per cent. cut)	1	8 2	0	19 9
Canada (1929)	0	2 9	0	17 3
New Zealand (1930)	1	0 2	0	16 3

14. The expenditure on the pensions group is increasing with increasing claims, and is estimated at £21,000,000 for 1931-32. A reduction of 20 per cent. would give a saving of £4,200,000. If this reduction is made, an increase in pensions annually in proportion to any rise in the cost of living might be considered.

15. The possible economies set by the standard of the reduction in the basic wage are then:—

Administration and business undertakings	£8,900,000
Pensions, &c.	4,200,000
Total	£13,100,000

16. The reductions in railway expenditure

the rate of about £12,000,000 per annum in the first quarter of 1931, and it is not certain that it was adequate. Private assistance has been supplementing public funds, but the source must tend to dry up, particularly if the sacrifices proposed in this report are accepted.

21. It is certain that the public funds available will be strained to provide even bare subsistence. It is essential under present conditions to make them go as far as possible, and not use them for the maintenance of a comparatively small number at ordinary wage rates. It may be hoped that the revival of confidence aimed at in the general plan of this report will gradually improve employment and make the funds provided sufficient. But the possibility must be contemplated that unemployment relief may exceed the provision for it by as much as £3,000,000, so that this sum may be added to the gross deficit, and to the inescapable debit balance which remains to be met by loan, when everything possible has been done to increase revenue and decrease expenditure.

22. To make economies appreciably greater than £13,000,000 would require either a sacrifice of public servants out of proportion to that of those in private employment or such a curtailment of the services rendered as should be contemplated only in the last resort. The following table shows the rigidity of certain elements in Government expenditure:—

Table III. National Income and Government Expenditure

Year.	National Income.	Total Government Expenditure.	Total Interest, Sinking Fund, Exchange, and Unemployment.
1927-28	£ 650	£ 187.4	£ 57.8
1928-29	645	189.1	61.6
1929-30	564	194.3	64.4
1930-31 (estimated)	485	196.9	77.2
1931-32 (estimated)	450	197.5	84.3

Note.—The expenditure is as set out in the estimates submitted to the Committee.

The first column in the table shows the grave fall in the national income. It is a summary statement of the narrowed resources of both individuals and Governments. Public expenditure, however, has not lessened proportionately, the main reason for its rigidity being revealed in the third column showing the amounts required for interest and sinking fund, exchange, and unemployment relief. That portion of the government expenditure in which reduction has been practicable shows a decline between 1929-30 and 1931-32 from £129,900,000 to £113,200,000. With the further drastic cuts that are both possible and imperative this total would be reduced to £100,200,000. This would represent a fall of 23 per cent. in adjustable expenditure, which includes expenditure on pensions and social services as well as wages and salaries of public servants. The whole brunt of the reduction of public expenditure would thus fall on the recipients of these payments. They would bear their full share of the loss of national income, yet the resultant economies would have been largely swallowed up by increased charges for interest, exchange, and the relief of unemployment.

23. On the basis of economies proposed a saving of £13,000,000 possible in 1931-32 may be set against estimated deficits of £39,000,000. There remains a gap of £26,000,000 to be bridged.

The second step—possible increase in revenue—must now be considered.

III.—POSSIBLE INCREASES OF REVENUE

24. The possibilities of increase of revenue from higher charges for services of the Railways, Post Office, &c., may be dismissed as already sufficiently explored by the respective authorities. There remains taxation.

25. The only substantial increase in taxation proposed by any Government—according to the information supplied—is the Federal tax on the interest on Government bonds. This is left out of account for the present, because it is in effect included in the broader proposals discussed in the next section.

26. Income Tax is the first resort, but the limits of taxation of income are not far off in most of the States. It appears, however, that about £1 per head additional income tax might be raised in Victoria and Western Australia without making the taxation more severe than in the other States. That increase would give £2,200,000 additional

tion, and it suggests that another £2,000,000 from some form of direct taxation is the limit. This is exclusive of a levy on interest, which is discussed in the next part.

33. The most obvious instrument for this increased taxation is the Income Tax. A substantial amount could be raised by steepening the scale for moderate incomes from about £700 upwards. For very high incomes probably no appreciable increase is possible above the combined Federal and State taxes in some States. The possibility of reducing exemption in the Federal tax to the old figure of £200 requires investigation with full consideration to the necessity of the States. Taxation of single persons might be made more severe. The possibilities of aggregating incomes for State taxation, with the Commonwealth as collecting agency, and the general standardising of assessment, exemptions, abatement, and scales between all the States and the Commonwealth should be explored. Land taxation as an alternative method of supplementing revenue should also be considered. Entertainments taxes might be extended to the lower admission charge. The Committee thinks it desirable to leave the final details open, and simply to indicate an additional £2,000,000 of direct taxation, which it believes to be about the limit of what can be wisely obtained in this way.

IV.—POSSIBLE MEANS OF BRIDGING THE GAP

34. There is still a gap of £14,000,000 to bridge, and it is now necessary to consider the burden of interest. This problem must be faced. Unless the present drift in Australian finance is stopped the end will be default. The fears expressed in this regard by the Under-Treasurers in their report to the Loan Council in February have already been shown to be not unfounded. They wrote:—

"The evils which would follow such default would be immeasurably greater than any hardships which the nation need be asked to face in order to restore Australia to a sound position. Panic conditions would be produced in financial spheres—involving Banks and Savings Banks. Business would be paralysed. Insolvencies would be the order of the day. Unemployment would be general. Recovery would be indefinitely protracted."

35. But while it remains true that "the gravest danger to confidence lies in the unbalanced condition of Government budgets," the revenue has fallen so much further below expenditure that "reduction in Government expenditure," though it is more imperative than ever, is no longer, as they found it, "the key to the whole position."

36. Economies and increased taxes such as those outlined above involve as drastic cuts as can be borne by income-elements that are exposed to both cuts and taxes. Yet the gap still to be bridged remains a wide one. For two reasons further measures to reduce it are necessary. The sacrifices asked from wages, salaries, and pensions are so great that they would not be accepted if any other income-element escaped. Nor may the menace of currency collapse be ignored while the deficit to be met by borrowing remains so large.

37. The holders of fixed money-claims have already borne taxation as part of a special Commonwealth tax on property of 1/6 in the £ (7½ per cent.) and may have suffered reduction of such income as they derive from other sources. But their incomes from fixed money-claims have not been reduced to the same degree as other income-elements. Outstanding amongst them, from the point of view of the public finance, are the holders of Government securities, for whom the danger inherent in unbalanced budgets carries its gravest threat.

38. This threat affects most directly the internal bondholder. Measures that will obviate it must therefore include him, but they must leave untouched the external creditor. The external creditor has not the responsibility for the financial position which every Australian citizen must share. Moreover, default or attempts to vary the contracts with external creditors would rob us of assistance that is necessary, both in preventing collapse and in opening the road to recovery.

39. There are two methods by which, without a technical breach of contract, contributions might be exacted from internal holders of fixed money-claims. One is that of raising the price level either by the issue of additional currency or by the creation of bank credit. There can be little doubt that under present conditions such a policy would destroy confidence in the currency. With such loss of confidence

II.—THE LIMIT OF POSSIBLE ECONOMIES

5. The total deficits so estimated are roughly £31,000,000 for 1930-31, and £39,000,000 for 1931-32. For the following years on the same assumption the deficits would tend to increase on account of interest and sinking fund on deficits, increased interest on conversion, and the burden of postponed charges.

6. The financial problem may be considered in three steps—

- What further economies are possible?
- What increases in revenue can be got from taxation or any other source?
- If these fail to meet the probable deficit, what further measures are necessary?

7. What further economies are possible? A standard for economy is given by the Federal Basic Wage, which has now fallen 20 per cent. below the level of 1928 and is, for the present, likely to remain at about this level. (The fall is even greater compared with 1929.) It is equitable, on the whole, that all wages and salaries in the Government service should have the same percentage reduction as the Federal Basic Wage. Incidentally all salaries and wages should conform to the same standard.

8. Consider now the application of this standard to the expenditure in the following departments, exclusive of any capital charges:—

Departmental—

- Defence.
- Education.
- Charitable Expenditure and Public Health.
- Police and Penal Establishments.
- Mines, Lands, Survey, Agriculture, Forestry.
- Miscellaneous.
- Public Utilities—
- Post-office.
- Railways.
- Water Supply and Sewerage.
- Other Public Services.

The item "Miscellaneous" includes for the States practically all other expenditure (chiefly cost of administration) except Public Debt Charges, Roads, and Unemployment.

9. The expenditure on these activities is predominantly the cost of wages and salaries—in some items almost exclusively so. What is not wages and salaries is generally food or material. The cost of material on the average either has fallen, or may be expected shortly to fall, to about 10 per cent. under the 1929 level. Certain material, on account of the increase in protective duties, may not have fallen in price to the public, but that will not affect the Commonwealth (the Post-office is chiefly concerned) so far as the material is still imported. The Commonwealth does not pay Customs duty. The dominating factor in railway material is coal, the price of which has fallen about 20 per cent. in three States.

10. In addition to savings in the rate of wages and salaries and in the price of material, there will be the ordinary economy of stricter and more efficient administration. There will also be a reduction of expenditure on account of the smaller volume of business. This particularly affects the Railways and the Post-office. On balance the possible saving in the Departments enumerated can be safely reckoned at 20 per cent. on the expenditure for 1929-30, assuming a reduction of 20 per cent. in the rates of wages and salaries. For Railways, on account of the great reduction of traffic, the possible savings on this basis should be substantially more than 20 per cent. on total expenditure.

16. The reductions in railway expenditure would be appreciably greater than 20 per cent. There are some other items of expenditure, such as roads, repatriation, and some "miscellaneous" Commonwealth expenditure to which the 20 per cent. cut has not been applied, and these will contribute some substantial saving by the uniform reduction of the wages and salaries included in them. On the other hand, there are some items included in the "cut" expenditure, such as loss on soldier settlement, to which the suggested cut is not applicable.

16a. A reduction of 20 per cent. over a large field of expenditure has been proposed for all Governments. There were large differences between Governments in their scale of expenditure in 1929-30, so that a uniform cut would not entail uniform sacrifice. The expenditure of South Australia in 1929-30 was below the Australian average, yet that State will show a 20 per cent. reduction of expenditure in 1931-32, although wages and salaries have not yet been cut by the full 20 per cent. It is certain that some of the other States can make an appreciably greater reduction than 20 per cent. with the same effort. These margins above 20 per cent. the committee leaves in general to cover possible errors in its calculation of total economies at £8,900,000. In the case of New South Wales, however, the margin is large enough for special mention. The general costs of Government in that State have been at least £1 per head higher than the average of the other States. It is clear then that further reduction of expenditure of £2,000,000 to £3,000,000 is possible for New South Wales above that provided by the uniform cut, which alone is taken into account when possible economies are set down at £8,900,000.

17. Greater Treasury control of expenditure on roads would be secured if motor taxation were taken into ordinary revenue. The revenue for 1930-31 from motor taxation and the special petrol tax will amount to about £6,000,000 and is estimated at £5,200,000 for 1931-32. In the ordinary course of events this would all be used for the maintenance and construction of roads and to meet interest on past construction. The expenditure might now be limited to maintenance and interest. With the reduction in wages and salaries proposed, this would make possible a saving in expenditure of at least 25 per cent., or over £1,200,000. With this included we may safely put the economies possible on the above basis at £13,000,000.

18. No reduction has been suggested in the expenditure on unemployment. In some States it is met by special taxes earmarked for the purpose; in others it comes out of general revenue. It appears that the expenditure provided for in the Treasurers' forecasts for 1931-32 is about £11,000,000. Is this enough?

19. The percentage of unemployment in reporting unions was 25.8 in February. From this it may be inferred that the total number of unemployed in Australia was then about 360,000, of which 80,000 was the normal number unemployed, not from want of employment, but from sickness, change of work, holidays, &c. If unemployment expenditure were confined to providing sustenance for the balance of 280,000, the cost would probably exceed £12,000,000.

20. It may be possible to devise and carry out positive constructive plans for the relief of unemployment, though all such schemes would require heavy capital expenditure. It is not the business of this committee to consider such schemes, but only to enquire how sufficient funds can be obtained to meet the accepted obligation of Governments to provide sustenance. Government expenditure on unemployed relief was at

increase would give £2,200,000 additional revenue. Beyond that some increase, but no very great one, is possible for all States through the Federal Income tax. The amount and manner of it may be deferred for the moment.

27. In an emergency of this kind when income taxation is reaching its limit, recourse must be had to some form of taxation which falls on everyone's consumption without directly increasing the cost of production to any considerable extent. A tax of this kind is found in most countries by a duty, Customs and Excise, on some common and important food such as sugar or tea. In Australia this is not possible because the consequent higher prices are passed on automatically through wages, and exaggerated in the process, so that they fall ultimately on export industry, which in present circumstances is least able to stand increased burdens.

28. In Australia, a tax of this kind may be found in a Sale Tax or Primage Duty, provided that in either case the basic foods are exempt. These taxes fall only to a small extent on industry, and have also the advantage over tea and sugar duties that their incidence is much lighter on lower income, which (in other countries) bear an undue proportion of a tax on sugar or tea.

29. The administrative difficulties of a Sales Tax are great, but we are committed to them for the present Sales Tax, and they will not be greater for a higher tax. There is also a Primage Duty operating and there is no technical difficulty in increasing it. The Sales Tax must be raised to 6 per cent., and the Primage Duty to 10 per cent., with care that in both cases basic foods are exempt and possibly also the more important goods which are direct instruments of production, such as machinery, fertilisers, cornsacks, &c. The proceeds would be:—

Increased Sales Tax (from 2½ per cent. to 6 per cent.)	£5,600,000
Increased Primage (from 4 per cent. to 10 per cent.)	2,400,000
	<hr/> £8,000,000

30. The question of the valuation of imports should be considered in connection with Sales Tax and Primage. It is understood that proposals are under consideration for both valuing imports and collecting ad valorem duties in Australian currency. This change from existing practices might bring in a net increase of Customs revenue of £2,000,000 to £3,000,000. Such an increase in taxation, if it is adopted, should not be in addition to, but rather in substitution for part of the increased primage duty suggested later.

31. The increased Primage Duty and the valuation of imports in Australian currency, if adopted, should be accompanied by the abolition of embargoes and rationing in respect of imports imposed during the last two years, and by a reduction of some of the extreme protective duties. Such measures would be no longer necessary and their removal would promote better feeling overseas, or at least offset any unfavorable reaction to increased primage and the higher valuation of imports. On the whole about £8,000,000 should be obtained from a combination of Primage, Sales Tax, and a revaluation of imports, accompanied by a reduction of embargoes and high Customs duties, and a more liberal exemption of basic foods and instruments of production. (The principles of these exemptions require careful detailed statements, which cannot be attempted here). These proposals would yield £10,000,000 of new taxation, which reduces the gap between revenue and expenditure in 1931-32 to £16,000,000.

32. The Committee does not think that much more can be wisely obtained by ordinary methods of tax-

With such loss of confidence in the currency. With such loss of confidence both interest and exchange rates would rise. The rise in exchange would increase the cost of meeting overseas interest obligations, and therefore upset the whole plan for budget equilibrium. The increase in interest rates would be damaging to conversion operations and again impose an additional strain upon the Budget. The net effect would be to increase the deficit and to require an increasing amount of new credit and currency to be created for balancing the budgets in successive years. Under these circumstances an inflationary policy would soon get out of hand and bring about a collapse of the currency.

40. The other method of exacting contributions from holders of fixed money-claims through familiar forms of law is that of further Commonwealth taxation of income from property. This might fall on all such claims, both private and public. There are two outstanding objections to further taxation of income from property generally:—

(1) The imposition of it as a permanent feature of the Budget would force up the rate of interest. This would make future conversions possible only at a higher nominal rate, which would, in large part, if not entirely, affect the producer of the tax.

(2) The reductions of wages and salaries proposed above, and the increased taxation of reduced incomes, would create problems of private finance as serious for the budget of the individual as those which are today baffling Governments. With higher rates of interest the wage-earner who will have lost from 20 to 30 per cent. of his wages will be called upon to pay higher interest on a house mortgage. The grazier, the value of whose clip has been halved, the farmer, whose harvest is selling at unprecedented prices, will be debited with higher interest charges. Such stresses must give rise to a continued clamor to the Legislature for relief, surrender to which would militate against every effort made to balance public Budgets.

41. If, however, the state of the Budgets should make necessary a temporary recourse to so undesirable an expedient, the terms of its enactment should include machinery for its automatic reduction or removal. Incomes from property are already subject to a special Commonwealth tax of 7½ per cent. If an additional tax of 15 per cent. were super-imposed for a limited term, the rate of tax should be made to fall automatically with the rise of prices, disappearing if they rose to 15 per cent. or if the conversion operation described below is undertaken and successfully completed.

42. Other methods may be considered by which contributions from fixed money-claims may be obtained, but which involve breach of contract. In normal times breach of contract would constitute an insuperable objection, but, fundamental as is the sanctity of contracts, it must not be overlooked that insistence on their fulfilment to the letter might, in present circumstances, force the debtor Governments into a policy that would surely destroy the value of the bond. Generally, breach of contract would cause lack of confidence, and would set up a flight of capital from the country subjecting investors to it. But when the alternatives are inflation and default, or taxation of an equal or probably greater severity, holders of fixed money-claims may find it wiser to accept a variation of their contracts which is less onerous than taxation, and insures them against the greater loss of total default.

43. One possible method is an immediate conversion of Government securi-

