The Evolution of Australian Treasury Thought Since 1945

by

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I certify that the thesis entitled The Evolution of Australian Treasury Thought Since 1945, presented for the degree of Doctor of Philosophy, is the result of my own research, except where otherwise acknowledged.

Signed: [Signature]

Date: 19.1.82

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Professor Whitwell provided distinguished service to staff and students of the Faculty from 1982-2011.
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Preface

This thesis aims to provide an understanding of the changing economic philosophy of the Australian Treasury, an institution of undoubted importance in influencing the nature of post-war economic policy but one which has been largely neglected by economic historians. As a corollary, the thesis aims also to make some (though of course a very limited) contribution to an even more significant gap in Australia's post-war economic history: an analysis of the contours of Australian economic thought in general.

Recently, Fred Gruen has provided a survey of Australian economics from 1968 to 1978\(^1\) and Geoff Harcourt has discussed the leading schools of economic thought in Australia - monetarist, bastard Keynesian, and post-Keynesian - and has related them to some key economic institutions, including the Treasury.\(^2\) Both of these are valuable contributions but are notably brief. Barry Hughes's *Exit Full Employment*\(^3\) is much more comprehensive and discusses Treasury thought in some detail but, as with Gruen and Harcourt, is concerned essentially with the 1970s. This thesis, by contrast, covers not only the 1970s but stretches back to the 1930s in an attempt to show how Treasury thought has evolved over more than four

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decades (with emphasis on the post-war period).

To be more specific, the thesis is not a history of how the Treasury has influenced policy but aims to piece together the various elements of the Treasury's outlook - the way it views the economy and economic agents - to show how this view has changed over time, and to explain why it has changed. Given these aims, it seems essential to abandon a narrative style for an explicitly analytical and hermeneutical approach. For narrative would tend to obscure the extent and nature of the changes which have occurred in Treasury thought and obscure also the interrelatedness of the department's ideas. Liberal (but hopefully not excessive) use has been made of quotations. Such quotations are essential for giving flavour to the ideas discussed. More importantly, in an interpretative essay language is crucially important.

Finally, some mention should be made of possible complaints concerning the style of the thesis. Perhaps the main complaint which could be raised is that the thesis is overly relativistic, in that it concentrates on tracing the evolution of Treasury thought and says little about the validity of the department's views. This is openly acknowledged. Nevertheless, before one can criticise (or support) the Treasury it seems essential to know something about what the department really thinks. It seems essential also to know why the Treasury thinks the way it does. In both these respects the thesis has some value. Hopefully, the thesis will convince the reader of an important fact: ideas about the world are not static but variable and assumptions made about human nature are of fundamental importance in determining one's view of the world and the economy. One has to be quite clear of these assumptions before one can
engage in debate over which is more realistic.
Acknowledgements

In the course of preparing this thesis I have received support, encouragement, guidance and even sympathy from a variety of people. A few of these deserve particular thanks. To begin on a technical note, Silvia Rametta patiently and skilfully led me through the intricacies of using word processors, for which I am most appreciative. Sonia Puglielli also provided much assistance and cheerfully and promptly answered my queries. Over the last year or so my physical and mental condition has been a source of constant concern to my parents; they have been ever-anxious to provide assistance and as always have shown unlimited generosity. Simone Hutchinson has had to put up with so much over the last three years, particularly over the last six months, and has somehow managed to tolerate my state of preoccupation. I apologise, again, for placing such a strain on our relationship. Among the members of the Economic History Department of the University of Melbourne, I am pleased to record my heartfelt thanks to Judy Tyers for her support and for her intelligent and stimulating conversation; the latter provided welcome relief from the thesis and reminded me of the importance of topics other than Treasury thought. Ross Muir always enquired after my progress and we were able to sympathise with each other over having to meet deadlines. My greatest debt is to my supervisor, Professor Boris Schedvin, whose influence on my outlook in general and my approach to economic history in particular has been considerable. The thesis has benefitted from his insight, wisdom, perspicacity, and breadth of knowledge and vision.

January 1982
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<tr>
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<td>General Financial and Economic Policy Division</td>
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Part One:

Methodological and Theoretical Perspectives
Introduction to Part One

The central proposition of this thesis is that Treasury thought has evolved in the post-war period from a predominantly Keynesian model to a predominantly neoclassical model. Parts Two and Three of the thesis survey the trend of Treasury thought since World War II in an attempt to validate this proposition. Such an attempt, however, is not possible until certain preliminary issues have been discussed. For the analysis in Parts Two and Three is placed within the bounds of a particular methodological and theoretical superstructure. In order to appreciate the analysis it is necessary to explore this superstructure and understand its ramifications. Part One of the thesis, consisting of three chapters, undertakes this act of exploration. Its aim is to make the superstructure explicit.

As a starting point, it is essential to outline what the Treasury does, to examine how its functions and structure have changed over time, and to discuss the department's recruitment pattern. To place the analysis in perspective, it is necessary also to discuss how the Treasury established and maintains it undoubted authority in the field of economic advice. In short, it is necessary to provide an introduction to the Treasury. Chapter One fulfils this need.

Chapter Two is concerned with methodological issues. It clarifies the meaning of the term 'model' as it is used throughout the thesis and examines the validity of the notion of a Treasury 'model' or 'view'. It seeks also to survey the documentary and other material from which the Treasury's underlying model may be extracted.
Chapter Three is concerned with theoretical issues. It is a key chapter. The meaning of 'Keynesian' and 'neoclassical' is explained at length; the differences between the two models are highlighted; and some of the ways in which the models have been synthesised are considered. The chapter discusses first the neoclassical model (using as its main sources the writings of Marshall, Walras and Robbins), then the Keynesian model (concentrating on Keynes's post-1930 writings), and concludes by examining the synthesising efforts of writers such as Hicks and Samuelson.
A necessary preliminary to studying Treasury thought is to examine the role and the organisational structure of the department and to outline how they have changed over time. This is the primary aim of the present chapter. Another aim is to discuss the educational background of Treasury officers—to describe the changes that occurred in the department's recruitment pattern during and since World War II. Clearly, an understanding of such matters will provide the means for a greater appreciation of the discussion in the rest of the thesis: it seems obvious that before one can analyse Treasury thought one has to know something about the function of the department and about the intellectual background of its officers. To place the analysis in perspective, one also has to be aware of the relative importance of the Treasury, within the Public Service, on economic matters. Thus another, and final, aim of this chapter is to answer the question: what is the basis of Treasury authority? The topics of role, structure, personnel and authority are discussed in that order.

The traditional role of [Treasuries], described in that well-known phrase about looking after the candle-ends, has always been to assist governments in making the most economical use of public moneys. That role has, of course, been greatly changed—though it remains of great importance—in a world in which
the emphasis has switched to broader policies of full employment and economic growth, and in which the role of governments has become increasingly 'activist' rather than 'passive'.

- The Treasury, 1966

The traditional function of Treasuries was to act as the government's accounts keeper, to act as its financial watchdog. This involved overseeing the raising of revenue for government activities and controlling departmental spending. In the days when government budgetary policy was devoted to the balanced budget principle, an additional function of the Treasury was to make sure that the budget did indeed balance. Treasury attitudes were dominated by accounting principles. As a necessary corollary of its financial watchdog function, Treasury officers were (and continue to be) imbued with a keen interest to ensure value for money, to prevent wasteful and profligate spending, to maintain departmental spending within prescribed limits and, if possible, to reduce expenditure.

The role and importance of the Australian Treasury up until 1930 was notably limited. In 1930 F.A. Bland complained that the Australian Treasury lacked the trained personnel and the organisation available to the British Treasury with which to scrutinise departmental estimates of receipts and expenditure. C.B Schedvin argues that until 1930 the


Australian Treasury 'was little more than the government's department of accounting: it had little influence and did not have the equipment or skill to advise the government of the likely effects of its policies'. 4 He points out that the Treasury supervised but did not direct government revenue collection and expenditure. The unimportance of the Treasury with regard to economic matters was reflected in Bruce's suggestion in 1929 that a Commonwealth Bureau of Economic Research be established. The Bureau was to be quite independent of the Treasury. Its prime function, as set out in the Economic Research Act 1929, was to carry out economic research into such areas as primary industries, secondary industries, marketing, transport, customs and excise tariffs, bounties, industrial matters, taxation, and finance and currency. 5 Such topics, or at least their economic, as distinct from their financial, significance, were presumably at best of only marginal interest to the Treasury.

During the 1930s, however, there occurred a considerable enlargement in the scope of the Treasury's responsibilities. This development was linked with the growing financial domination of the Australian government over the States. In particular, it was linked with the establishment in 1929 of the compulsory Loan Council (as a result of the 1927 Financial Agreement). The establishment of the Council brought a measure of centralised decision-making to economic policy which previously


5 The Bureau was also required to investigate and report to the Minister on: the granting of assistance for the promotion of economic research; co-operation in economic research with academic and other bodies in Australia and elsewhere; and the establishing and awarding of economic studentships and fellowships. The 1929 legislation, however, was never acted upon.

6
had been lacking. It also greatly enhanced the importance and responsibility of the Treasury. As Schedvin explains:

the Council was an extremely cumbersome body and was ill-suited for the swift formulation and implementation of policy that was necessary during the depression. Meeting as it did three or four times a year, it could do little else than frame policy in terms of vague generalities, and it became the responsibility of the Commonwealth Treasury to work out the details and improvise whenever necessary.... The detailed and intricate problem of maintaining national solvency was entirely in the hands of the Commonwealth Treasury, as were the negotiations with the banks to provide finance for all budget deficits.6

With the acquisition of these additional responsibilities, the Treasury's function by the end of the 1930s was considerably in excess of its traditional role of keeper of the public purse and saver of candle ends.7

Even greater changes in the role and responsibilities of the Treasury were to occur during World War II. As the Treasury itself has noted: 'Progress toward the present position was steady, if haphazard, in the pre-war years but the 1940s witnessed something of a quantum jump.'8

As a result of the Uniform Tax legislation of 1942 and the assumption of responsibility by the Labor government for a variety of social service benefits, the financial power of the Federal government increased considerably and, as a result, so too did the responsibilities of the Treasury. But more fundamentally, the acceptance by the Federal government during World War II of the notion of economic control (to be discussed in

6 Schedvin, Great Depression, pp. 375-6, 93.
7 On the enlargement of the Treasury's role prior to 1939, see also Crisp, 'Treasury's Changed Role', pp. 319-21.
Chapter Four) had a profound impact upon the Treasury. The economy was now to be kept under close and continuous surveillance; not only present but prospective trends in spending and the level of economic activity would be under scrutiny. Aggregate expenditure was to be consciously and purposively manipulated so as to iron out boom-slump cycles and maintain full employment. Such activities required a vast array of statistics, especially of the Keynesian aggregate type. They also required personnel capable of interpreting these statistics and recommending appropriate policies. And this, together with the exigencies of war, led to considerable changes in the size, responsibilities and educational qualifications of the Treasury (and of course of a number of other departments). The Treasury became responsible not just for financial management but also for economic management. Not only did the Treasury have to act as the keeper of the public purse, as the government's accountant, but now it also had to make recommendations on how budgetary and monetary policies could be used to regulate the level of economic activity.

As will be seen in the following section, the Treasury remained responsible throughout most of the post-war period for both financial and economic management. In 1976, however, the Treasury was split and the role of financial management was entrusted to the new Department of Finance, leaving the Treasury responsible solely for economic management.

**Structural Changes since 1943**

The Treasury's first organisational overhaul since its establishment at Federation occurred in 1943. The reorganisation, which took effect in
October of that year, involved allocating the department's responsibilities between eleven Sections: a) General Financial and Economic Policy; b) Budget and Finance; c) Accounts; d) Loans; e) Economic Controls; f) Transport, Works and General Services; g) Defence and Lend-Lease; h) Social Services; i) Primary Production; j) Capital Issues and Actuarial Matters; and k) Correspondence and Records.

The establishment of the GFEP Section was testimony to the change in the Treasury's responsibilities which occurred during the war. By the end of 1945 the Section consisted of five officers, all with economics training. As the name suggests, the responsibility of the Section was to provide advice on general economic policy issues as well as to undertake economic research. It formed the nucleus of economic expertise within the department. The concern of the other Sections was essentially financial rather than economic. Reflecting the importance attached to stabilisation policy, the power and importance of GFEP was to increase steadily throughout the post-war period.

Despite the 1943 reorganisation the Treasury remained a relatively small department - that GFEP was made up of only five officers is evidence of this. The upper echelons of the department were also limited in size. The Federal Guide of June 1943 lists the Secretary to the department and two Assistant Secretaries (one in charge of Administration and the other in charge of Finance). The Federal Guide of January 1944 reveals that the 1943 reorganisation resulted in the creation of only one additional Assistant Secretaryship (listed as Assistant Secretary [General]). In 1945, however, the position of Deputy Secretary was created. A.C. Joyce was appointed. Upon this change, Joyce's former position of Assistant Secretary (Administrative) was dropped and replaced by Assistant Secretary.
Chart 1.1: The Australian Treasury, 1945

THE TREASURER

- MARINE WAR RISKS INSURANCE
- WAR DAMAGE COMMISSION
- ADVISORY COMMITTEE FINANCIAL & ECONOMIC POLICY
- SECRETARY TO THE TREASURY
- COMMISSIONER OF TAXATION
- NATIONAL DEBT COMMISSION (SINKING FUND)
- BD OF BUSINESS ADMINISTRATION (DEFENCE)

DEPUTY SECRETARY

- C'WEALTH ACTUARY
- CONTROLLER OF ADVERTISING
- SUPERANNUATION BOARD
- ASST SEY GENERAL
- FIRST ASST SEY DEFENCE, EYN
- ASST SEY FINANCE
- ASST SEY ECONOMIC CONTROLS
- COMMONWEALTH STATISTICIAN
- GOVERNMENT Printer

- CAPITAL EXPENSE CONTROL
- LAND SALES CONTROL
- CORRESPONDENCE & RECORDS
- PUBLIC LOANS
- LOAN COUNCIL MATTERS
- RECEIPROCAL LEND-LEASE ADMINISTRATION
- BUDGET & ESTIMATES
- C'WEALTH EMPLOYEES COMPENSATION
- ACCOUNTANT
- INSURANCE DEPOSITS
- STORES SUPPLY AND TENDER BOARD

- STAFF MATTERS
- ENEMY PROPERTY
- "CENTRAL ACCOUNTS"
- "SUB-TREASURIES"

- TRANSPORT, WORKS & GEN. SERVICES
- DEFENCE & LEND-LEASE
- GENERAL FINANCIAL & ECONOMIC POLICY
- SOCIAL SERVICES
- PRIVATE PRODUCTS
Chart 1.1 shows the Treasury's organisation at the end of 1945. Five of the eleven Sections, including GFEP, it can be seen, were directly responsible to the Deputy Secretary, one was under the Commonwealth Actuary and the remaining five were spread between the three Assistant Secretaries.

In 1946 another major reorganisation took place which provided the mould in which the Treasury remained for over two decades. The reorganisation involved compressing the eleven Sections into five Branches: a) Loans and General Services; b) Budget and Accounting; c) Banking, Trade and Industry; d) Social Services; and e) General Financial and Economic Policy. Each of the officers in charge of these Branches was made an Assistant Secretary. At the top of the structure was the Secretary (S.G. McFarlane) and the Deputy Secretary (George Watt, who had been First Assistant Secretary in charge of the Treasury's Defence Division in Melbourne, became Deputy Secretary in 1947 when Joyce was appointed Commonwealth Auditor General).

Apart from two cosmetic changes in 1963 - the Division under the Commonwealth Actuary and Insurance Commissioner was given Branch status and the Banking, Trade and Industry Branch was renamed Commerce and Industry - the 1946 Branch structure remained largely intact until 1969. However, during this period a number of important changes occurred within the Branch structure. In particular, several First Assistant Secretarial and Assistant Secretarial posts were created. The Deputy Secretaryship also underwent changes. When Watt became Secretary in 1948 the position of Deputy Secretary was dropped. It was resumed in 1957 when Richard Randall was appointed to the post. In 1962 the additional post of Deputy Secretary (Supply and General) was created. C.L.S. Hewitt was appointed. The
Federal Guide of 1965 lists the Secretary, two Deputy Secretaries, five First Assistant Secretaries and eleven Assistant Secretaries (as well as the Commonwealth Actuary and Insurance Commissioner). By 1968 two additional Assistant Secretaryships had been created.

The organisation of the Treasury in 1966 is shown in Chart 1.2. The chart reveals the expansion of the department and the attendant increased division of labour. The expansion of GFEP is particularly noticeable. By 1966 it consisted of five Divisions and six Sections and had more Assistant Secretaries than any other Branch.

The Treasury's expansion must be seen in perspective. The department's responsibilities and work load have tended to increase more rapidly than the additions to available staff with the result that a shortage of staff has been an enduring Treasury phenomenon. In 1964 R.W. Cole of the Treasury pointed to 'the continuing, indeed growing, shortage through the 1950s of staff of adequate calibre and attainments' which, he argued, 'seems to have been common to the Public Service as a whole during that period'. Evidence of the staff shortage of the 1950s is provided by the fact that no Branch or Division was devoted full-time to the job of budgetary control. Those officers responsible for scrutinising the budget estimates did so for three or four months prior to the budget and then resumed normal duties. The situation was not much better in the 1960s, as Bruce Juddery testifies: 'In the late 1960s the Treasury was


understaffed and over-worked, the more so the closer one approached the top. For many second division officers, the flow of paperwork had become a flood which threatened to engulf them.'

In an endeavour to improve this situation, a major reorganisation of the Treasury was effected in 1969. The purpose of the reorganisation, as the Secretary, Richard Randall, explained, was 'to secure a very considerable strengthening of the department in the second division area because that's where the work has been pressing most heavily; we strengthened it by dividing the work over a wider range'. The reorganisation involved the creation of three additional Branches: Overseas Economic Relations, Financial Institutions, and Defence and Works. Several name changes occurred: Budget and Accounting became Accounting and Supply, Commerce and Industry became Transport and Industry, Social Services became Social Security, and Loans and Investment became Revenue, Loans and Investment. In conformity with the rest of the Public Service, the eight Branches were now referred to as 'Divisions'.

The reorganisation involved a considerable bolstering of the Treasury's upper echelons. Between September 1968 and September 1969 the number of First Assistant Secretaries increased from thirteen to twenty-two. Over the same period the number of Class 11 Third Division officers jumped from thirty-six to fifty-five. Randall attempted to gain a third

13 Juddery, At the Centre, Appendix, Charts 5a and 5b.
Deputy Secretaryship but failed to persuade the Public Service Board.¹⁴ This decision, however, was later reversed and in 1971 the position of Deputy Secretary (Economic) was created. John Stone was appointed.

But apart from these quantitative changes, the 1969 reorganisation also involved important qualitative changes in the work of the GFEP Division. Until 1969 GFEP bore the main responsibility for advising on both internal and external policy matters. However, with the creation of Overseas Economic Relations in 1969, GFEP's task of advising on external economic policy was transferred to the newly-created Division. Also in 1969, Revenue, Loans and Investment acquired from GFEP responsibility for Commonwealth-state financial relations. A further sharing out of tasks occurred in 1972 when the Foreign Investment Division was created and took over responsibility for a number of matters previously of concern to GFEP and Overseas Economic Relations.¹⁵ These various changes are reflected in Chart 1.3 which shows the structure of the Treasury in 1974.

By the end of 1972, then, the number of Divisions responsible for economic policy advice had expanded from one to four. GFEP and Overseas Economic Relations were responsible for advising on general policy matters: the former being concerned predominantly with internal (domestic) matters; the latter with external matters. As one would expect, there was a degree of overlap between the concerns of the two Divisions. Foreign Investment and Financial Institutions were 'specialist' Divisions. As its name suggests, Foreign Investment's formal responsibilities were limited

¹⁵ The Treasury, Submission to the RCAGA, Attachment 'B', p. 3.
to foreign matters, 'including in particular investigation and reporting to
the Foreign Investment Review Board on foreign investment policy and the
Foreign Takeovers Act'. Financial Institutions was to concentrate on the
'structure and functioning of the banking system and other financial
institutions in the Australian capital market, insurance, company
structures and financing, currency, Australian capital investment abroad
and exchange control'. Mention should also be made here to Revenue,
Loans and Investment. Until 1976 RLI was a hybrid, exercising both policy
advising and Supply functions. Its functions included overseeing the
various grants and payments made by the Commonwealth to the States as well
as the raising of Commonwealth loans in Australia and overseas, managing
the Public Debt and acting as the Secretariat for the Australian Loan
Council.

Despite the structural changes listed above, GFEP remained the
premier Division in the Treasury. One senior ex-Treasury officer
(described as having 'extensive experience' in the department), testified
to this in evidence before the Royal Commission on Australian Government
Administration (the Coombs Commission):

Let's be damn honest about Treasury - and no one has challenged
this in the department that I've spoken to - there is a
distinct pecking order. There is no question that Finance and
Economic Policy is a cream division. It is cultivated, it has
very high standards of entry, and high standards of promotion,
all from within the division.... It is the area to be in when
it comes to establishing priorities.

3.
17 Ibid., p. 2.
18 Commonwealth Directory, February 1972, (Commonwealth Government
Following FEP Division, we have probably on a par Overseas Economic Relations, Revenue, Loans and Investment, and Foreign Investment Divisions. There would not be much between them in terms of prestige or power or pecking order or whatever. Then on a par as a third tier, Financial Institutions Division and Trade and Industry Division, and the rest just follow. Defence and Works, Social Security, Accounting and Supply are just nothing - they don't really count and if you work in those divisions you really don't count either. Management Services just doesn't get a mention. 19

The primacy of GFEP is indicated by its tendency and ability to meddle in the affairs of other Divisions. Its power is such that, despite complaints, it sometimes rewrites advice prepared for the Treasurer by other Divisions. It does this with the Secretary's blessing. 20 The Report of the Coombs Commission pointed out that 'the integration of the various divisions [of the Treasury] is sometimes seen from both within and outside the Treasury as excessive domination by the division responsible for financial and economic policy', and continued: 'It has been argued ... by departments that the views of the relevant sections of the Supply Divisions about the expenditure proposals of departments within their area of responsibility are frequently over-ruled on the basis of a priori judgements from the policy division.' 21

The 1969 organisational structure remained intact until November 1976 when the Fraser Government decided to split the Treasury and hive off several of the Treasury's functions to the new Department of Finance. As noted, Finance was made responsible for financial management and expenditure

19 Quoted in RCAGA, Interviews on Treasury Controls, Research Paper (Special Collections) No. 60, (microfiche, Monash University), Interview 1, paras. 79-80.

20 Weller and Cutt, Treasury Control, p. 30.

control, leaving Treasury responsible solely for economic policy advice. The Accounting and Supply, Defence and Works, Social Security, and Transport and Industry Divisions were relocated in Finance. Finance also acquired Sections and Branches from Revenue, Loans and Investment, GFEP and Overseas Economic Relations. The split, particularly the reasons for it, is examined in more detail in Chapter Nine.

In summary, throughout the post-war period the Treasury grew steadily (in 1969 relatively rapidly) and so too did the division of labour within the department, particularly in the area of economic policy advice. However, both before and after the split of 1976 GFEP remained the key policy advising Division. It is essentially the views of GFEP and, of course, of the various Secretaries and Deputy Secretaries, which is examined in Part Three.

**Treasury Recruitment Patterns: The Rise of the Treasury Economist**

We may dislike this new breed of theorists who masquerade under the name of economists, but they will be with us for a long time.

- D.B. Copland, 1946

From World War II onwards the Treasury experienced fundamental changes in the educational qualifications of its recruits. The most important changes


were, first, the appointment of university graduates to its upper echelons and, second, an overwhelming preference for economics graduates. These changes were not unique to the Treasury and should be seen as part of a broader revolution in the recruitment patterns of the Public Service and beyond.

Advancement in the Public Service traditionally involved a tedious climb up from the bottom ranks. Recruits, usually in their early teens, entered by way of competitive examination. From the end of World War I up to 1932, however, the vast majority of vacancies were filled by ex-servicemen, whose educational standards, according to Sol Encel, 'were, in general, lower than those prescribed for normal peacetime entrants - themselves not notably high'.

By the beginning of the 1930s there was considerable pressure on the Commonwealth Public Service Board to introduce a system of graduate recruitment. In 1933, in the face of this pressure, the Commonwealth Public Service Act was amended and Section 36A inserted. This Section permitted the recruitment of graduates under the age of twenty-five. However, the annual intake was restricted to no more than 10 per cent of the proposed outside appointments to the third division.

A decade later Robert Parker complained that the graduate recruitment scheme had not been given a 'fair trial' and pointed out that the number of candidates entering the Service under the scheme had fallen

considerably short of the 10 per cent quota. There were a number of serious drawbacks in the scheme, as Parker explained:

The method of enlistment is not such as to attract the best products of the Universities (though one or two exceptionally good men have been obtained). Without any special prospects of advancement, and carrying the salary of a junior clerk, these positions cannot be regarded as bait for 'first class' or 'good second class honours' men ... competition for the posts has been practically non-existent. And when enlisted, the graduates have, with few exceptions, been placed on routine clerical work, thus violating one of the most important principles established by study of the requirements of administrative cadres.

With the failure of the graduate recruitment scheme and, more particularly, with the dominance of ex-servicemen, the Public Service was left ill-equipped to handle the administrative strains imposed by World War II. It soon became apparent that there was an imperative need for outside help, given that the Federal government's war-time responsibilities were burgeoning rapidly. An urgent recruitment drive resulted in the appointment of businessmen, academic staff and state public servants to the Commonwealth Service. In the appointment of outside help, traditional promotional channels were ignored. Seniority gave way to skill and expertise. The number of employees employed under the Public Service Act jumped from 47,000 in 1939 to 95,000 in 1946; by 1951 the total was 147,000.

25 Between 1934 and 1941 only sixty-seven graduates (out of 204 applicants) were admitted to the Service. The distribution of degrees was as follows: B.A. - 36; LL.B. - 18; B.Com./B.Ec. - 6; B.Sc. - 1. About two-thirds of the graduates went to External Affairs, Attorney-General and Treasury. Encel, 'Recruitment of University Graduates', pp. 225-6.


were employed on a temporary basis with the result that over half of the 95,000 employees were designated as temporaries.\textsuperscript{28} Many of the temporaries, however, elected to retain their positions after the war ended; by virtue of Sections 44 and 47 of the Public Service Act they were granted permanent status. In 1953 fourteen of the twenty-nine First Division officers in the Service had been war-time temporaries.\textsuperscript{29}

Of considerable relevance to the Treasury was the fact that the war was associated with an influx of young economics graduates. Perhaps the most notable of the Treasury's economics recruits was H.C. Coombs, a doctoral graduate of the London School of Economics, who was borrowed from the Commonwealth Bank at the outbreak of war. Coombs retained the position of Treasury Economist until 1942 when he moved to Melbourne as Director of Rationing; later he was to head the Department of Post-War Reconstruction. Other economics recruits included Frederick Wheeler and R.J. Whitelaw. Wheeler, who entered the Treasury in 1939 in the new position of Research Officer, had studied Commerce part-time at the University of Melbourne during the 1930s while working at the State Savings Bank. Whitelaw joined the Treasury in 1941 as Research Officer. Whitelaw was also a graduate of the University of Melbourne, holding degrees in both Arts and Commerce (majoring in economics in both). In 1943 Wheeler and Whitelaw joined with Frank Pryor, an honours Arts graduate of the University of Sydney who had entered the Treasury in 1941, and N.F. Stuart, an M.A. graduate of the University of Melbourne who had entered the

\textsuperscript{28} Encel, 'Recruitment of University Graduates', p. 228.

Treasury in 1940 after working in the Economist's Department of the Commonwealth Bank and with E.J. Morgan & Co., to form the newly-established GFEP Section. Wheeler was placed in charge.

Prior to World War II senior Treasury posts were dominated by men with accounting backgrounds. In 1944 the Treasury was headed by S.G. McFarlane, the Secretary, A.C. Joyce, Assistant Secretary (Administrative), J. Brophy, Assistant Secretary (Finance), and W.C. Thomas, Assistant Secretary (General). Joyce, Brophy and McFarlane were deeply imbued in accounting techniques and conventions. Brophy, for instance, born in 1889, joined the Public Service in 1908. He was appointed accountant at the Brisbane Sub-Treasury in 1919 and remained there until 1927. From 1927 to 1930 he was accountant at the Melbourne Sub-Treasury. In 1933 he moved to Canberra to become Treasury accountant and in 1943 was appointed Assistant Secretary in charge of finance. Similarly, both McFarlane and Joyce entered the Public Service at a relatively young age and spent many years in accounting posts on their way to the higher Treasury echelons.

The influx of economics graduates during the war was the beginning of an important trend in the recruitment pattern of the Public Service. In 1948 when Section 36A was resumed (it had been suspended in 1941) the various government departments asked for 134 graduates in Economics, twenty-three in Economics or Arts with a major in economics, thirty-seven in Arts and twenty-seven in Law. Although the departments actually received only fifty-six graduates in Arts, thirty-one in Economics and nine in Law, Copland's claim that economists 'will be with us for a long time'...

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31 Ibid.
was on the way to being vindicated. S.J. Butlin could comment in 1948:

the last ten years have seen an outstanding new development. The economic adviser has taken the back-seat where he belongs, and where he need not trouble the driver who keeps his eye on the road; in his place is the economic expert who has gone into the public service as a career.... Scarcely a department but has its economic division or section, its Principal Economist, its research officers, and its subscription to *Econometrica*. The Public Service Board has established permanent scales of salaries for economists of various grades, with specifications of the required qualifications, and the conditions for climbing the promotion ladder. In Canberra the economist has arrived.\(^{32}\)

Certainly within the Treasury the economist had arrived. This was evident in 1951 when, with the appointment of Roland Wilson as Secretary, the Treasury was headed for the first time by an economist.\(^{33}\) Wilson's qualifications were impeccable: a Bachelor of Commerce from the University of Tasmania, a Diploma of Economics and Political Science from Oxford, a doctorate from Oxford and a doctorate from the University of Chicago.

By the end of the 1950s Economics and Commerce graduates dominated the second division of the Treasury and, as Table 1.1 shows, this trend continued and intensified in the 1960s and 1970s. This table, which is grouped according to the chronological divisions adopted in Part Three of the thesis, shows the educational qualifications of first and second division Treasury officers (Assistant Secretaries, First Assistant

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33 Wilson's association with the Treasury began in fact in the 1930s. In 1932 Wilson left his post as lecturer in economics at the University of Tasmania to fill the newly-created position of Economist in the Statistician's Branch of the Treasury. In 1936 he was appointed Commonwealth Statistician. In the same year, in recognition of his importance within the department, he was given the additional title of Economic Adviser to the Treasury. He held both positions until 1940 and again from 1946 to 1951.
Table 1.1: Academic Qualifications of First and Second Division Treasury Officers, 1956-79

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>B.Ec./B.Com.</td>
<td>11</td>
<td>13</td>
<td>30</td>
<td>34</td>
</tr>
<tr>
<td>B.A.</td>
<td>7</td>
<td>7</td>
<td>12</td>
<td>16</td>
</tr>
<tr>
<td>B.Sc.</td>
<td>1</td>
<td>1</td>
<td>5</td>
<td>6</td>
</tr>
<tr>
<td>B.Eng.</td>
<td>-</td>
<td>-</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>LL.B.</td>
<td>-</td>
<td>-</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>B.Phil.</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>1</td>
</tr>
<tr>
<td>B.Ed.</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>1</td>
</tr>
<tr>
<td>Diplomas</td>
<td>3</td>
<td>1</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>M.A.</td>
<td>2</td>
<td>2</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>M.Ec.</td>
<td>-</td>
<td>1</td>
<td>3</td>
<td>1</td>
</tr>
<tr>
<td>M.Sc.</td>
<td>-</td>
<td>-</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>LL.M.</td>
<td>-</td>
<td>1</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>M.P.A.</td>
<td>-</td>
<td>-</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>M.B.A.</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>1</td>
</tr>
<tr>
<td>Ph.D.</td>
<td>3</td>
<td>5</td>
<td>3</td>
<td>3</td>
</tr>
</tbody>
</table>

Total Degrees, Diplomas 27 31 63 75

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Hons.</td>
<td>5</td>
<td>6</td>
<td>19</td>
<td>22</td>
</tr>
<tr>
<td>No Qualifics.</td>
<td>3</td>
<td>3</td>
<td>4</td>
<td>3</td>
</tr>
<tr>
<td>Unknown</td>
<td>-</td>
<td>-</td>
<td>10</td>
<td>7</td>
</tr>
</tbody>
</table>

Total Officers 22 25 58 59

Notes: 1. Information on educational qualifications comes from the listings in Who's Who in Australia and from the Treasury, Submission to the RCASA, Attachment (c).

2. The Table does not include officers in the Insurance and Actuarial Branch nor those in the Defence Division. It does include, however, officers in the Defence and Works Division - created in 1969.

3. Four of the five officers who have Masters degrees do not state their first degree.
Secretaries, Deputy Secretaries and Secretaries) listed in the various Federal Guides and Commonwealth Directories. The dominance of Economics and Commerce graduates is obvious but is in fact understated as many of the Arts graduates and some of the Science graduates majored in economics.

Evidence submitted by the Treasury to the Coombs Commission in 1975 revealed a high educational standard among its officers. Out of a survey of 685 officers, 497 had completed tertiary qualifications, ninety-six had incomplete qualifications (such as incomplete degrees) and only ninety-two had no tertiary qualifications. Of the 497 officers with completed tertiary qualifications, 389 had one qualification, ninety had two qualifications and fifty-four had three qualifications, giving a total of 623 degrees.34

Table 1.2 classifies these 623 degrees according to discipline. It shows, as one would expect, that Economics and Commerce graduates are dominant not just among senior officers but throughout the Treasury ranks. Table 1.2 shows also, however, that despite the dominance of Economics and Commerce graduates, there is a considerable diversity of disciplines among Treasury officers. It is interesting that Science and Arts (Mathematics) is the second highest grouping of graduates. This reflects in part the post-war mathematisation of economics (to be discussed in Chapter Three) and in part the Treasury's involvement with the National Income Forecasting model.

The high level of educational attainment by Treasury officers is indicated also by the large percentage of honours degrees shown in Table

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34 The Treasury, Submission to the RCAG, Attachment (a).
### Table 1.2: Completed Tertiary Courses by Discipline, as of 1975

<table>
<thead>
<tr>
<th>Discipline</th>
<th>Qualifications</th>
</tr>
</thead>
<tbody>
<tr>
<td>Administration</td>
<td>19</td>
</tr>
<tr>
<td>Management</td>
<td></td>
</tr>
<tr>
<td>Arts and Humanities</td>
<td>52</td>
</tr>
<tr>
<td>Economics, Commerce and Arts (Economics)</td>
<td>442</td>
</tr>
<tr>
<td>Education/Teaching</td>
<td>22</td>
</tr>
<tr>
<td>Law</td>
<td>10</td>
</tr>
<tr>
<td>Science and Arts (Mathematics)</td>
<td>63</td>
</tr>
<tr>
<td>Computing</td>
<td>8</td>
</tr>
<tr>
<td>Ph.D.</td>
<td>7</td>
</tr>
<tr>
<td><strong>Total Qualifications</strong></td>
<td><strong>623</strong></td>
</tr>
</tbody>
</table>

**Source:** Reproduced from the Treasury, Submission to the RCAGA, Attachment (a).

1.1. Although this is evident particularly from 1969 onwards, given that the table refers to senior officers many of these honours graduates would have entered the Treasury much earlier. It is relevant in this respect to consider Table 1.3.

### Table 1.3: Honours or Higher Degrees as a Proportion of Degrees held by Third Division Permanent Staff in Selected Departments, 1968-74

<table>
<thead>
<tr>
<th>Department</th>
<th>1968</th>
<th>1972</th>
<th>1974</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public Service Board</td>
<td>23.3</td>
<td>30.5</td>
<td>34.3</td>
</tr>
<tr>
<td>Treasury</td>
<td>34.8</td>
<td>43.0</td>
<td>45.6</td>
</tr>
<tr>
<td>Service Overall</td>
<td>27.1</td>
<td>27.8</td>
<td>27.4</td>
</tr>
</tbody>
</table>

This shows not only a particularly high proportion of honours or higher degree graduates among Treasury officers but reveals also that the Treasury proportion is well above that of the Public Service as a whole and has been steadily increasing whereas the Service has remained constant. Similarly, Table 1.4 shows that the Treasury has a much higher proportion of graduate and diplomate staff than the Service overall.

Table 1.4: Graduate or Diplomate Staff as a Proportion of Permanent Third Division Staff in Selected Departments, 1968-74

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Public Service Board</td>
<td>38.6</td>
<td>45.8</td>
<td>51.1</td>
<td>49.6</td>
</tr>
<tr>
<td>Treasury</td>
<td>20.9</td>
<td>33.9</td>
<td>41.8</td>
<td>48.6</td>
</tr>
<tr>
<td>Service Overall</td>
<td>14.2</td>
<td>23.8</td>
<td>25.8</td>
<td>26.3</td>
</tr>
</tbody>
</table>

Source: As for Table 1.3

In summary, World War II witnessed not only the assumption of responsibility by the Treasury for the provision of economic advice but also the beginning of a fundamental shift in the department's recruitment pattern: adolescent clerks and ex-servicemen began to be replaced by economists who were a product of secondary and tertiary education and whose academic qualifications tended to be well above average. By the end of the 1950s the Treasury economist had not only arrived; he now predominated.

Treasury Economic Authority

The Treasury's authority in the field of economic policy advice, though
considerable, has never been absolute. During World War II responsibility for economic advice was borne by a number of departments and committees; the Treasury was one of several sources of advice and it is not at all clear whether it was the most important. By 1950, however, its main rival, the Department of Post-War Reconstruction, had been wound up and the Treasury had risen to pre-eminence. The Treasury's position with regard to economic matters was further strengthened in 1951 with the appointment of Roland Wilson as Secretary. But by the end of the 1950s the Treasury's authority was once again under threat - this time from the Department of Trade. Competition from Trade proved to be persistent; it continues today. Nevertheless, despite this competition the Treasury's supremacy in the field of economic policy advice was undoubted throughout the 1950s and for most of the 1960s, the reasons for which will be explored shortly. During this period newspaper reports sometimes fostered the impression that the Treasury virtually dictated government policy. For example, discussing the budget strategy of 1958 the Sydney Morning Herald referred to 'one of the most intensive operations for some years designed to "soften up" the minds of wavering members of Cabinet] to the idea of the absolute minimum of concessions', and continued: 'Hardly anyone - Minister of ordinary member - can now think of the Budget strategy outside the terms of reference laid down and vigorously "sold" by the Treasury.' A week later the paper

35 For an overview of the Treasury's fluctuating influence in Federal politics, see Weller and Cutt, Treasury Control, pp. 22-7.


reported that the department's recommendations seemed 'to have swept all before it.... Ministers were hypnotised by the Treasury financial analysis.' 38

It was not until John Gorton's Prime Ministership, which lasted from 1968 to early 1971, that there occurred the first notable decline in Treasury power. Gorton was inimical to the Treasury, believing it to be obstructionist and 'conservatively sterile'. 39 In both 1969 and 1970 he rejected the department's advice that stringent budgetary measures be introduced to counter mounting inflationary pressures. And in the face of stolid Treasury resistance, Gorton introduced legislation to regulate foreign take-overs and established the Australian Industries Development Corporation. 40 After Gorton's demise and his replacement by William McMahon, the Treasury was once again in command. The budget strategy of August 1971 was seen to be a clear Treasury victory. But beginning in about mid-1974, with the ALP now in power, the department once again suffered a set-back. In fact, from mid-1974 to about mid-1975 the Treasury was virtually ignored. The Labor Caucus shared Gorton's sentiments and resented the department's persistent attempts to push a single line of advice. It became convinced that Treasury was bent on bringing the

38 'Treasury View Adopted', Sydney Morning Herald, 8 July 1958.


government down.\textsuperscript{41}

Under Malcolm Fraser, despite some initial conflict, the Treasury's influence has been paramount once again. It is testimony to the influence of the department that the Fraser years have been dubbed the 'Stone Age' - in dubious honour of John Stone, the current Treasury Secretary.\textsuperscript{42} But as on other occasions, the Treasury's position has been far from monopolistic. In the 1970s the Prime Minister's Department emerged as a powerful force in economic policy advice. And during the Whitlam years the Department of Urban and Regional Development was able to exercise a degree of influence at the expense of Treasury.\textsuperscript{43}

Throughout the post-war period there have been demands that an alternative body to the Treasury be set up. Lobbying for such a body was particularly intense in the second half of the 1940s and in the first half of the 1960s. In 1945 D.B. Copland, in his capacity as Economic Adviser to the Prime Minister, suggested in a Parliamentary report that an Economic


\textsuperscript{43} On the relationship between DURD and Treasury, see Martin Painter and Bernard Carey, \textit{Politics between Departments: the Fragmentation of Executive Control in Australian Government}, (University of Queensland Press, St. Lucia, 1979).
Section be set up in the Prime Minister's Department. This section would be responsible for economic and statistical research and analysis. Copland considered it 'highly desirable that the economic analysis and the preparation of basic statistical material should be independent of the pressure of any individual department, or of the political trends of policy at any time'. This would require independence from Treasury and from the spending departments. The Economic Section, however, would work in 'close co-operation' with the Treasury and other departments such as Commerce, Labour and National Service, and Trade and Customs. In 1946 the Pinner Committee, in its Final Report, adopted a similar line and recommended that an Economic Secretariat (or 'Planning Body') be established within the Prime Minister's Department which would act as a central co-ordinating authority. In 1949 pleas for an Economic Secretariat to be established in the Prime Minister's Department were renewed, this time with greater vigour. The main protagonist on this occasion was the Department of Post-War Reconstruction, which was to be disbanded soon after the 1949 federal elections. According to Crisp, 'some of those in senior posts in the [Post-War Reconstruction] Department, especially the staff of its Economic Policy Division, were strongly attracted to the idea of a useful and

45 Ibid., paras. 72, 73.
46 Office of the Public Service Board, Central Office, Records of the Committee of Review on Civil Staff of War Time Activities, 1945-46, Australian Archives Accession CP 23/2, File L. The Pinner Committee was appointed in June 1945 to investigate the civil staffing of wartime departments and agencies. Neither the various departmental reports nor the Final Report were published.
influential future in a reorganised Prime Minister's Department'.

In the first half the 1960s, this time as a result of seemingly inept economic management, there was once again a rash of calls for the establishment of a planning section within the Prime Minister's Department. There were suggestions also that a separate Department of Planning be set up. Initially such demands were made primarily in academic circles and in newspaper editorials. In 1965, however, the Committee of Economic Enquiry (the Vernon Committee) attracted widespread publicity, and a stinging rebuttal from Menzies, by recommending that an economic council be set up to provide advice on long-term trends and policies. By implication the Treasury was to have been restricted to questions of short-term economic management.

It is testimony to the Treasury's power that it has been able to fight so effectively against such proposals. The Treasury was not able, however, to prevent the establishment in 1949 of an Economic Policy Division in the Prime Minister's Department. But as it turned out, the division proved to be an ineffective alternative to the Treasury. The division's potential power was nipped in the bud following the change of government late in 1949, partly because the new Prime Minister, R.G. Menzies, was disinterested in economic policy-making and its detailed ramifications. Moreover, a major lesson for Menzies arising out of the events of 1941 was the need to maintain a harmonious relationship with the

47 Crisp, 'Central Co-ordination', p. 32.

Country Party. Arthur Fadden, the Country Party leader and Deputy Prime Minister, was Treasurer. Thus, any attempt to establish an effective alternative to the Treasury would have run the risk of placing coalition relationships in jeopardy.\(^49\) In comparison to the Treasury, the Prime Minister's Economic Policy Division seemed particularly weak. As L.F. Crisp has commented:

> Though, man for man, it may have matched a like number of Treasury men in native ability and training, if not always in experience, the Division was in fact a mere handful in the early years a dozen at most. By contrast, the Treasury not only commanded incomparably more 'troops', but both their traditional and their relatively newly-developed functions alike presented them in their normal course of business with incomparably wider and more authoritative direct command of the stuff of policies and the most obvious levers of co-ordination.\(^50\)

This points to a key factor in understanding how the Treasury was able to establish and maintain authority in the field of economic advice: the fact that its traditional function of financial controller enabled it to become involved in the whole gamut of governmental activities. By 1949 Copland could point to the 'great importance which has been attached to the position of the Treasury in relation to the whole of the operations of the Commonwealth Government'. Copland continued: 'There is now scarcely any important agency on the controlling authority of which the representative of the Treasury is not a key person.'\(^51\) By 1954 J.G. Crawford could refer to 'the joyous struggles of a Permanent Head in organization, management and staffing matters which nowadays seem to involve him with Treasury


\(^{50}\) Ibid., p. 40; emphasis in the original.

hardly less than with the Public Service Board'. The Treasury's role of government accountant empowered it to participate in the activities of nearly all departmental and inter-departmental committees which involved expenditure of public funds. This not only enabled the Treasury to have its finger in every financial pie but enabled it to claim that it was in the unique position of being able to consider spending proposals from a holistic point of view. As one senior Treasury officer put it: 'Treasury does not claim to be the seat of all wisdom, but it is in an advantageous position to see the financial picture as a whole'. Similarly, the Treasury has been able to claim that it is the only department able to see the economic picture as a whole. Whereas departments such as Trade and Urban and Regional Development were concerned only with particular aspects of the economy, the Treasury can point to the fact that it is concerned with both domestic and external economic conditions and policies and with their interrelationships. This, in turn, enables it to claim that it is in a much better position than its myopic departmental rivals to judge what is in the national interest.

Also of relevance in understanding how the Treasury was able to establish its authority in economic matters was the fact that throughout


53 M.W. O'Donnell, 'Purposes and Practices of Treasury Policies and Controls'; quoted in Crisp, 'Treasury's Changed Role', p. 317. This seems to be a common Treasury proclivity. Hugh Heclo and Aaron Wildavsky, in their study of the British Treasury, noted that '[Treasury] spokesmen never tire of pointing out their uniquely broad perspective'. One official, for example, argued that: 'We are the only department that sees the whole picture.' See Hugh Heclo and Aaron Wildavsky, The Private Government of Public Money, (Macmillan, London, 1974), p. 42.
the 1940s and 1950s and beyond the department was headed by Treasurers who exercised both power and influence in Cabinet. First under J.B. Chifley, then Fadden and Harold Holt (and later McMahon) the Treasury was able to ensure that its view was accorded weight and (often decisive) influence in Cabinet. Chifley, who became Treasurer in 1941, laid the foundations. Chifley, as described by Paul Hasluck, was a 'tower of strength ... [,,] receptive to his department, strong in the Cabinet, shrewdly practical and quiet moving'.\(^{54}\) From 1945 Chifley was in the unique position of being both Treasurer and Prime Minister. He was to retain both posts until 1949. In 1950, reflecting on Labor's achievements, he congratulated himself on having built up a strong Treasury team. He told Fadden, his successor:

> Although I do not expect the Treasurer to admit the fact publicly, I feel that he must realise the debt he owes to previous Labour Administrations for having assembled in the Treasury such a group of outstandingly able officers. When Labour was in office it always paid great attention to the selection of officers to fill important positions in the Public Service, and when I was Treasurer I did not pay regard to the personal convictions of prospective appointees but was concerned solely with their competence. I wanted the highest order of ability.\(^{55}\)

Fadden, like Chifley, was a powerful force in Cabinet. As noted, he enjoyed the advantage of being both leader of the Country Party and Deputy Prime Minister and this was a key reason why the Economic Division in the Prime Minister's Department proved to be an ineffective alternative to the Treasury. Fadden remained Treasurer until 1958. He was succeeded by Harold Holt. Holt, too, was influential in Cabinet (as evidenced by the

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fact that he succeeded Menzies to the Prime Ministership in 1966) and a firm supporter of the Treasury line.56

Chifley's comment quoted above points to another key consideration in understanding how the Treasury has achieved an authoritative position in economic matters: its reputation for unsurpassed intellectual strength and expertise. Treasury officers are keen to promote the notion that they represent an educational elite within the Public Service. As one officer put it in reply to criticism that the Treasury was 'educated and privileged, cossetted and selfish': 'We earn our power by being right. People who get things wrong lose power.'58 The Treasury's pride in its intellectual expertise can be seen in the following passage by R.W. Cole on the problems associated with acquiring staff for the Financial and Economic Surveys Division, established at the end of 1962:

The fact is that people of the calibre and background training in economics required for this sort of work, if it is to be done at normal Treasury standards, are extremely short within Australia. Although positions at various levels in the Division have been advertised on a number of occasions for application by persons both inside and outside the Public Service, the response has been limited in terms of the quality sought. It would, no doubt, have been possible to fill vacant positions by lowering standards; but no long-term good could come of the acceptance of such a short-term view.59


57 These criticisms were made by Justice Staples in the 1980 Chifley Memorial Lecture at the University of Melbourne. For an outline of the speech, see Michael Gordon, 'Treasury Men Cossetted and Selfish, says Staples', The Age, 10 September 1980.


Such comments reflect Chifley's declaration that he wanted people in the Treasury who were only of 'the highest order of ability'. The notion of the department being an elite permeates this passage, especially in the reference to there being only a handful of people of the calibre to meet the Treasury's recruitment standards and the insistence that such standards would not be violated. Such a notion reinforces the Treasury's conviction that its analysis of the economic situation is superior to those of others: not only does the department have a more holistic viewpoint but its analysis is assumed to be necessarily more rigorously analytical than that of rivals because of the greater intellectual depth of the department.

Just as Treasurers have been important in establishing and maintaining Treasury economic authority, so too have the secretaries of the department. Treasury was particularly fortunate in having Roland Wilson as its head from 1951 to 1966. To some, Treasury and Wilson were synonymous - something not surprising after such a lengthy stewardship. Wilson was seen to be the epitome of the 'good Treasury man': confident, authoritative, resolute, academically gifted, coldly logical, acerbic, quick-witted and sometimes devastating in speech. Wilson appears to have had an almost domineering relationship with his Treasurers. Coombs points out that Fadden 'greatly admired Roland Wilson's capacity, and depended heavily on his judgement, but he found Roland too cold and unyielding for a wholly satisfactory partner. Indeed it could almost be said that he was a little afraid of Wilson's razor-sharp intellect, his intolerance of human frailty and his acid tongue.' Coombs argues that when Holt was Treasurer he 'relied heavily' on Wilson. In Holt's work as Minister for Labour and

National Service during World War II, Coombs continues, 'his association with Roland Wilson was a source of strength for him and when they came together again at the Treasury it ensured a continuance of that strength'.\textsuperscript{61} In the 1970s and 1980s Treasury has become synonymous with John Stone. Although there are fundamental differences between Wilson and Stone in their respective economic philosophies, the personal characteristics of the two are similar. But perhaps the key similarity between the two is an overwhelming desire to advance the Treasury view and secure its acceptance. That this end has so often been achieved is testimony to the capabilities of the department's leadership.

As recent events have demonstrated, Treasury power derives also from its access to, and sometimes monopolisation of, information. In 1975 the Task Force on Economic Policy attached to the RCAGA observed that one of the major criticisms levelled at the Treasury was that the department was 'unnecessarily reticent in providing information on the economic situation, the options available to the government, and the likely implications of exercising any one of those options'.\textsuperscript{62} In January 1979 a confidential report by a working party to the Crawford Committee on structural adjustment castigated the Treasury for not publishing its quarterly forecasts (which are based on its National Income Forecasting model). The working party complained: 'At the very least, information of this kind should be generally available within Government agencies and

\textsuperscript{61} Ibid., p. 270.

should also be provided to major non-Government economic organisations involved in forecasting and/or assessing the short-term economic outlook.' 64 Such criticism left the Treasury unmoved. A month later, John Stone, before the Senate Committee on Constitutional and Legal Affairs, declared that the Treasury would be seeking exemption for its forecasts under the proposed freedom of information legislation. 64 A number of factors prompted the department's move to gain exemption for its forecasts. Not least among these was a desire to retain power. As the Task Force on Economic Policy observed: 'Information is strength and the Treasury's control over a large amount of economic information and intelligence puts it in a strong position.' 65

Summary

The traditional function of Treasuries was to act as the government's accountant, to supervise the raising of revenue, to oversee departmental expenditure and to encourage financial efficiency and prudence. From the 1930s onwards the responsibilities of the Australian Treasury grew steadily, initially because of its role as secretariat to the Loan Council and later because of the federal government's involvement in an ever-


64 'Treasury Defends Private Forecasts', The Age, 28 February 1979. See also 'Senator Corrects Deity', The Age, 7 March 1979.

65 Processes of Economic Policy Making, para. 11.22. Similarly, Peter Wilenski has commented: 'In the public service, knowledge is power and it is not easily obtained from bureaucratic rivals.' Peter Wilenski, 'Ministers, Public Servants and Public Policy', Australian Quarterly, Vol. 51, No. 2, June 1979, p. 40.
widening field of activities, exemplified by the assumption of responsibility for a range of social security benefits, and because of the introduction of uniform taxation and the continuous increase in Commonwealth revenue which occurred thereafter. During World War II the Treasury became responsible also for economic management, for providing advice on economic conditions and policies. Associated with this new responsibility was a marked change in the educational qualifications of Treasury recruits. The Treasury came to be dominated by trained economists whose educational standards established for the Treasury a reputation for exceptional intellectual ability. Throughout the post-war period, particularly since the early 1950s, the Treasury has enjoyed an authoritative position in the field of economic advice. This is not to say of course that the government has always followed Treasury advice or to suggest that the Treasury is the only source of advice. What cannot be denied, however, is that the department has been a major force in the post-war period in shaping governmental attitudes and policy decisions. To investigate the Treasury's economic philosophy is therefore an exercise of some importance.
Chapter Two: Methodological Perspective

The first step to the understanding of men is the bringing to consciousness of the model or models that dominate or penetrate their thought and action.

- Isaiah Berlin, 1962

If we are to understand what human beings are, then we must uncover those models, interpretative schemes, and tacit understandings that penetrate human thought and understanding.

- R.J. Bernstein, 1976

The underlying theme of this study is that Treasury thought has evolved gradually since World War II from a predominantly Keynesian model through to, by the end of the 1970s, a predominantly neoclassical model. Such a theme raises a number of questions. Apart from the obvious issue of the meaning of 'Keynesian' and 'neoclassical' - discussed in the next chapter - an important question which arises is: what is meant by the term 'model'? Linked with this, one may query whether it is possible to make generalisations about Treasury thought: is it valid to speak of a Treasury 'model' or Treasury 'view'? In addition, there is of course the question: what documentary and other material is available with which to analyse the nature of Treasury thought? The purpose of the present chapter is to attempt to answer these three questions. It begins with a discussion of thesis sources, then explains the meaning of 'model', and concludes by examining the forces which combine to make the Treasury a relatively


cohesive department and which thereby provide some validity to the notion of a Treasury model. Its aim, in short, is to provide the methodological foundations of the thesis.

**Thesis Sources**

Anyone who doubts the competence, experience and wisdom of the Treasury should refer to the documents - the annual surveys of the Australian economy - put out by the Treasury, and in particular to the special White Papers which have been produced in recent years... [They] are admirably presented documents, lucid and pitched at a level which will ensure that they have the maximum impact on those interested in these subjects in Australia.

- Ian Allen, MHR, 1966

These Treasury Surveys have made an indispensable contribution to the understanding and public discussion of Australian economic problems. Perhaps their most significant feature is that they afford an insight into the thought and economic philosophy of those who, as senior advisers to the Commonwealth Government, play a determinative part in the making of economic policy.

- IPA Review, 1962

The key source of information on Treasury thought is the annual Economic Surveys it issued from 1956 to 1973. The surveys varied in length considerably, from a low of 8,000 words to sometimes as much as 18,000. The average length was in the region of 11,000-12,000 words. The surveys provided a continuous account and assessment of the Australian economy, overseas trends, and policy initiatives. The purpose of the surveys, as

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3 CPD, H of R, 52, 1 September 1966, p. 666.

described in the foreword to the 1958 Survey, was as follows:

The aim of these annual Surveys ... is to promote the widest possible understanding of our economic problems and especially of those that arise from national growth.... They are intended to bring together and interpret the main facts of our changing economic situation and to set forth the issues which these economic trends and necessities present. Many such issues are, of course, discussed from time to time in Government statements, such as the Budget Speech, but then usually from a special standpoint and in relation to some phase of policy. There is much to be gained from making, periodically, statements of a more comprehensive kind and without a specific policy context. 5

In that they were issued in mid-year, the surveys came to be regarded as providing an assessment of the economic context within which the annual budget was framed. Commenting on the first survey, the Sydney Morning Herald argued that each survey would 'give an idea of Treasury thinking in the few months' preparation leading up to the presentation of the Budget.... Its value lies in the fact that the public has been given an insight into the questions being considered by the Government some months before the practical measures are implemented in the Federal Budget'. 6

J.R. Wilson, commenting on the third survey, declared: 'This gives us some clues as to the direction in which official Treasury thinking is tending and, consequently, of the type of policy likely to be put up to the Treasurer in the course of the preparation of the Budget.' 7 However, the authors of the surveys, as noted, insisted that they were without a specific policy context.

In the 1959 Survey it was argued that:

The first step in forming policy is to identify problems and make their nature clear. That is essentially what these Surveys aim to do. They do not purport to cover all aspects of our economic affairs nor, indeed, to provide a full analysis of the particular matters with which they deal. But they do try to concentrate attention on key issues and to give an idea of what people in and around government circles are thinking about them.8

The Treasury's discussion of 'key issues' sometimes involved appending to the surveys special sections on particular topics then relevant to the economy, including: the conditions of growth; public finance in a growing economy; stability in a growing economy; economic planning; overseas investment; resources and their allocation; and reform of the international monetary system.

Unlike the Treasury Information Bulletins which also began publication in 1956, the surveys were not simply a collection of facts. As noted, their aim was not just to bring together the relevant facts of the economic situation but to interpret them. Despite comments about attempted objectivity, it was acknowledged that a particular point of view was being put forward: 'Necessarily, the Surveys put forward a point of view on the problems they discuss and it is likely that, both generally and in detail, many will disagree with that point of view.'9 It is because the surveys were an exercise in interpretation, because they were putting forward a particular point of view, that they are such a valuable source of information.

8 Foreword to The Australian Economy 1959, (Commonwealth Government Printer, Canberra, 1959).

9 Foreword to The Australian Economy 1958.
In the mid-1960s another valuable source of information on Treasury thought became available in the form of Supplements to the Treasury Information Bulletin. A spate of Supplements appeared from 1964 to 1966 on such topics as economic growth, overseas investment, the balance of payments, labour force projections, and investment analysis. Thereafter only one supplement on a special topic appeared: a revised projection of labour force trends which was published in 1970. Throughout the 1960s, however, a regular series of supplements devoted to national accounting estimates of public authority receipts and expenditure was published.

The scope of the supplements was much more restricted than the surveys. The supplements, however, considered their various topics in depth and were more rigorously analytical. Indeed there were complaints sometimes that the Supplements were too technical. For example, in a generally favourable review of *The Meaning and Measurement of Economic Growth*, *The Bulletin* argued: 'The only complaint about it is that it requires rather too much understanding of economics for the general public to understand.' ¹⁰

The supplements were a product of the Economic and Financial Surveys Division and they bore the mark of the head of that division, John Stone. The importance of the supplements is that they provided a portent of the style of Treasury thought which was to emerge in the 1970s when Stone became Deputy Secretary and then Secretary. They are of importance also because the outlook in the supplements provides an interesting contrast to that in the surveys.

In the 1970s the amount of information published by the Treasury, in comparison with earlier periods, was extensive. Seven Treasury Economic Papers (which replaced the supplements) were published: two in 1972-73 and five in 1978-79. The papers covered a wide range of topics: overseas investment, economic growth, structural adjustment, job markets, energy markets, the proposals for a New International Economic Order, and technological change. Each of these were detailed documents and all, bar one, were initially prepared as submissions to various inquiries or commissions. Also published were fifteen Treasury Taxation Papers, the Treasury submission to the Law Reform Commission, and a number of brief Supplements to the Treasury's Round-Up of Economic Statistics. The department also provided during the 1970s a detailed commentary, of steadily increasing length, on economic conditions and policies in its Statement No. 2 attached to the annual budget speech.

Other sources of information on Treasury thought in the post-war period include articles and papers written by departmental officers and, of course, articles on the department in journals, newspapers and books. Another useful publication is the Treasury's submission to the Coombs Commission which discussed the Treasury's role as controller of public expenditure and as economic policy adviser and which provided valuable information on the educational background of its officers, material which was used in Chapter One.

It will be noticed that no reference has been made to manuscript sources. This omission does not reflect any anti-empiricist bias. Rather, it results from the thirty-year access rule of the Australian Archives which forces the researcher concerned with post-war topics to rely heavily, sometimes exclusively, on published documents.
Given that the aim of the thesis is to examine the trend of Treasury thought, the nature of the available material does not constitute a major difficulty. Indeed in some ways it is advantageous in that it makes it easier to obtain a broad outline of Treasury thought and thereby see how the pattern of this thought has varied over time. Also, the risk of analysis giving way to descriptivism is lessened. Another strength of using published documents is that they are more reflective, more philosophical, more closely reasoned and broader in perspective than one would expect of hastily written departmental memoranda on day-to-day issues. While it would be desirable to have more information than that listed in the above outline, the available material is of sufficient quantity and of more than sufficient depth to trace the evolution of the department's ideas since 1956.

A key problem with using published material, however, is that there will be the inevitable claim that the views expressed therein are merely propaganda, that they represent not the views of the Treasury but the politically opportunistic sentiments of the government. An example is provided by H.W. Arndt. Commenting on the Treasury's discussion of economic planning in the 1962 Survey, he claimed: 'The official authors of the White Paper were told to defend the present Government's refusal to contemplate any form of overall economic planning. They made the best of a bad job.' Such comments can be, but need not be, interpreted to mean that the Treasury was simply complying with a governmental dictate and was not expressing its own views. Against such arguments, a number of points

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can be made. First, the opposite argument has often been put forward; it
has frequently been suggested that the notable feature of Treasury
publications is the willingness of the department to put forward its own
views, albeit diplomatically. J.B. Paul, for example, argued in 1973 that
'the people so far have had access to statements of the essential lines of
Treasury thinking, not "through the Parliament", but through the Treasury's
regular publications', and continued: 'These publications, however, have
entered, sometimes obliquely, so many well-argued reservations about
certain lines of policy favoured by the Government that one wonders for how
much longer these dissenting judgements will be given the same immunity
from concealment or suppression enjoyed by those advisers the Government
can hand-pick.'\textsuperscript{12}

Second, on occasions the Treasury itself has stressed that the
views in its documents were not necessarily to be taken as those of the
prevailing government. For example, in the foreword to Treasury Economic
Paper No. 7 it was pointed out: 'The views expressed herein are those of
the Treasury and do not necessarily reflect those of the Treasurer or the
Government.'\textsuperscript{13} And in \textit{Insurance Contracts}, the Treasury submission to the
Law Reform Commission, the Treasury noted: 'It is emphasised that,
although this submission is presented with the approval - indeed at the
suggestion - of the Treasurer, the views expressed are departmental ones
only, and are not to be taken as representing the views of or committing

\textsuperscript{12} J.B. Paul, 'Political Review', \textit{Australian Quarterly}, Vol. 45, No. 3,

\textsuperscript{13} The Treasury, Technology, Growth and Jobs: Treasury Submission to the
Committee of Inquiry into Technological Change in Australia, Treasury
the Treasurer or the Government in any way. These are conventional disclaimers but are significant nevertheless.

Third, and most important, it is essential to realise that the Treasury would choose to remain silent rather than publish something it did not believe in. The reasons for this are discussed in the third section of this chapter where it is argued that the Treasury is not a submissive department but, on the contrary, is keen to push its own view onto the government of the day.

The Meaning of Model

'Model' is indeed a very handy word; it can be pressed into service as a substitute for over a dozen words, and its convenient vagueness allows its user to avoid commitment to any strict idea.

- Fritz Machlup, 1960

Discussion in economics abounds with references to 'models'. The chances of misunderstanding this word are so great that we should not grudge the time for a few comments on 'model building' that may allay the fears of some readers who dislike new-fangled words and distrust abstractions that have proceeded so far that the feeling of familiarity is lost.

- Fritz Machlup, 1952

A fundamental postulate of this thesis is that it is possible to extract from the material listed above an underlying model (or models) of the economy. However, as Machlup points out, 'model' has assumed a wide variety of connotations in economics literature. Therefore, to avoid a terminological tangle it is important to explain the specific meaning of the word as it is used throughout this study.

'Model' is commonly used by economists in reference to the notion of econometric models - these being constructs used primarily for the purpose of prediction in which the relationship between limited specific and defined variables, all of which are assigned numerical weights, is articulated. 'Model' is also frequently used in a looser, broader sense. Sheehan, Derody and Rosendale, for example, refer to a 'consensus model' which they claim has underpinned nearly all recent empirical work in Australia on short-term economic policy. Some of the features of the 'consensus model' include the following:

a) Personal consumption expenditure is treated as a lagged function of one or more measures of household disposable income.

b) Business investment is treated as a showing long lagged responses to output changes.

c) Government expenditure is largely treated as exogenous, and as flowing directly into total output.

d) Price equations exhibit short-run Phillips curve effects, and also involve some form of mark-up on wage costs.

e) For the purposes of labour market equations, it is assumed that firms' output is demand determined rather than being determined by the level of output which firms are willing to supply, given the condition that the real wage not exceed the marginal product of labour.17

What is common to econometric models and this consensus model is that both constitute a series of causal relationships which simplify reality but which are designed to delineate the key forces at work determining economic change. Model building in economics, as McClelland points out, may include only universal causal generalisations or sometimes only probabilistic generalisations (which in turn will permit only deductive inference or inductive inference respectively). But in either case the term 'model' refers to a construct based upon observation of empirical data.

'Model', however, may be used to denote not an empirical construct but an intellectual construct, a largely unconscious construct which informs a person's interpretation of reality and, as a subset of this, of the economy. In this sense modelling refers to the act not merely of simplifying reality (as do economic models) but of structuring or categorising reality. It is relevant here to quote Isaiah Berlin:

Men's beliefs in the sphere of conduct are part of their conception of themselves and others as human beings; and this conception in its turn, whether conscious or not, is intrinsic to their picture of the world. This picture may be complete and coherent, or shadowy and confused, but almost always, and especially in the case of those who have attempted to articulate what they conceive to be the structure of thought or reality, it can be shown to be dominated by one or more models or paradigms: mechanistic, organic, aesthetic, logical, mystical, shaped by the strongest influence of the day - religious, scientific, metaphysical or artistic. This model or paradigm determines the content as well as the forms of belief and behaviour. 19

Two points which Berlin is making are, first, that people necessarily


develop particular attitudes and expectations about human nature, about the way that people do or should act and about the qualities that people do or should possess and, second, that a person's philosophy of human nature becomes the lens through which he interprets the world. As Wrightsman points out, a philosophy of human nature functions in at least two ways:

First, in an epistemological sense, it is a paradigm that sets forth a causal explanation of social phenomena. Secondly, psychologically speaking, it is a set of social schemata that a person uses to help him to understand his phenomenal world. Thus, it is both a framework for a person's behavioural manipulations and instrumental dealings with his social world and a set of mental representations of that social world itself - representations upon which his cognitive, symbolic operations are performed.\(^{20}\)

As used in this thesis the term 'model' refers, to modify Wrightsman, to a set of mental representations of the economic world.\(^{21}\)

The analysis concentrates on the assumptions made about how the economy operates, whether it has inherent tendencies, whether the system can and should be controlled, and whether the economy is amenable to law-like statements. Above all, it concentrates on the assumptions made about the nature of economic agents. The analysis seeks to show also, and this is an important reason why the term 'model' was chosen, the underlying structure or pattern of Treasury thought, to show the interrelatedness of seemingly unconnected features of the department's outlook.


\(^{21}\) Interestingly, the Treasury has itself argued, in a submission on structural adjustment, that: 'The submission suggests that basically different mental pictures of how the Australian economy works underlie different policy prescriptions in this area'. The Treasury, *Flexibility, Economic Change and Growth: Treasury Submission to the Study Group on Structural Adjustment, Treasury Economic Paper No. 3*, (AGPS, Canberra, 1978), p. 1.
There are three other points which need to be made in relation to the notion of model as it is used in this study. First, a person's model is often a blend of other, frequently quite diverse, models. Two people may have quite distinct models but may agree on certain facts, propositions and hypotheses. Second, and this is not surprising considering the first point, models can have contradictory, conflicting elements. Third, models can and do change. It follows from the discussion above that if a person's model does change, this means that the ways in which that person perceives and interprets the data of experience have changed.

The Validity of the Notion of a Treasury Model

Over time, an established department will build up a corpus of established policy (i.e. established by law to some extent and by departmental fiat and usage for the rest) backed by a corpus of established predispositions as regards possible developments or modifications. Together, these are frequently known as 'the departmental line'. As ministers and ministries come and go this will continue to be the focus of concern. Efforts more or less subtle and tactful will be made to assimilate new ministers and ministries and other political and community forces to it.

The test of a good, nimble-minded and sure-footed Commonwealth department in this context from the bureaucratic view-point, then, would seem to be its capacity, sensitively, to develop and defend its 'departmental line', sustaining its relevance, plausibility and viability while assimilating to it gracefully and graciously, policy innovations and changes 'wished' on the department by passing ministers. One has seen a good deal of that sort of exercise in Canberra, with the Treasury almost certainly taking out the award for best all-round practitioner

22 Berlin, 'Political Theory', p. 16.
23 Ibid., p. 17.
A key assumption of this thesis, which is linked with the belief that it is possible to extract an underlying model of the economy from the material considered earlier, is that it is possible also to make generalisations about the dominant features of Treasury thought at any particular point of time. In other words, it is assumed that 'model' can be used in a collective sense. This assumption, in turn, rests on the belief that the Treasury is a sufficiently cohesive department to enable the formulation of such generalisations. An important question, then, is: what forces breed sufficient cohesion within the Treasury to validate the notion of a Treasury model? This section considers this question and provides some illustrations of the department's cohesion.

The relative unity of the Treasury results fundamentally from the nature of the department's role. It is relevant in this regard to consider the following comments by a senior Treasury officer, Richard Randall:

Each year the requests for expenditure, coming from Departments and from people outside the Government, add up to a sum considerably greater than the Government is willing to spend. That, however, is not all. The Government, if left to itself, might be willing to spend a certain total sum of money in the year; but whatever that sum might be the taxpayers always think it is far too much and they demand, energetically and specifically, that expenditure be cut down so that taxation can be reduced. Somehow these competing demands must be reconciled and it is the benign role of the Treasury to reconcile them. It is a benign role because, if someone did not act as mediator, the position would become chaotic, even violent. If all the people who demand additional expenditures were brought together with all those who demand tax reductions and left to

fight it out, there could be open strife. Scenes of disorder might disgrace the capital city.

By interposing itself between the contending parties, the Treasury prevents this kind of thing from happening. It is the keeper of the Queen's Peace. It holds the contenders apart and, taking them one by one, with gentle persuasive art induces them to abate their demands until, at some point, the two sides of the account which is the budget add up to the same figure. Unfortunately, though perhaps inevitably, the Treasury shares the fate of all peace-makers in the process. Enthusiasts for this or that policy often mistake the Treasury for the real opposition and vent the strength of their feelings upon it. This accounts for the air of sad resignation which Treasury officers come to acquire in the course of time.25

The essence of Treasury life is conflict and disagreement with other departments. As Randall's comments indicate, the Treasury is sometimes seen by its rivals with unabashed enmity and at best as a necessary evil. The RCAGA pointed out in its Report that the Treasury was often criticised for being 'too privileged, too powerful, and too prone to substitute its own judgements, its own values and its own priorities for those of other departments, ministers and the government itself'.26 The Report correctly suggested that: 'It would be surprising if Treasury were a popular department. The task of drawing attention to the reality of constraints on what ministers, departments, parliamentarians and groups and individuals in the community would like to do or have done is not one which easily wins friends for those who perform it.'27 The fact that the Treasury has acquired a negative image breeds camaraderie - life as a Treasury officer becomes a case of 'us against them'. In a world of conflict, unity is


26 RCAGA, Report, (AGPS, Canberra, 1976), para. 11.3.13, p. 369.

27 Ibid., para. 11.3.12.
indeed strength, it is a means of fortification, a shield to deflect persistent attacks.

All departments desire power but in the Treasury's case power is deemed a necessity. For there will inevitably be a conflict between spending proposals and available financial resources (even in a situation in which balanced budget principles are not sacrosanct) and if the Treasury is to resolve this conflict successfully, which, it is argued, it must, it is necessary that it obtain power and influence. It would be an exercise in reductionism to assign the Treasury's concern with power merely to a pathological or ego-fulfilling desire for power as such. To the Treasury, power is a means to an end: access to power is necessary in order to fulfil its guardianship role. Given this need, unity is crucial. For unity, or at least the appearance of unity, is an essential ingredient in obtaining and maintaining power.

Another aspect of the Treasury's role which encourages cohesion is revealed in the following passage by Roland Wilson:

At the Treasury we tend perhaps to see the bad, as well as the good, in schemes that come before the Government a little more clearly than their promoters do. It isn't our job to decide, but it is our job to make the critical analyses of all that is put up to the Government. Hence, perhaps naturally, we tend to be looked on as pullers-apart of other men's pet ideas. What we do is a necessary part of the process of government. God knows, Australia has enough people promoting new schemes - there is no shortage of ideas. It's our business to help Cabinet to try to pick the best. 28

A number of points emerge. As in Randall's comments, there is a slight persecution complex - a sense of unjustly being seen in a negative light.

But also like Randall, the department's role is deemed essential, indeed crucial - it is a 'necessary part' of the governmental process. There is also an air of superiority in the belief that the Treasury is the linchpin of the governmental system and in the suggestion that the Treasury, unlike other departments, can see the faults as well as the virtues of particular schemes and can advise on which scheme is best. There is a close link here with the belief, discussed in Chapter One, that the Treasury is in the unique position of being able to see the economic and financial picture as a whole. Other departments, it seems, are myopic and lacking in objectivity. Such beliefs perform the important role of encouraging a sense of self-esteem which is reinforced by the Treasury's reputation for outstanding intellectual ability.

The Treasury's confidence in its own expertise cannot be explained away as mere arrogance. The assured confidence of departmental officers in their own worth results in part because of the need, mentioned earlier, to maintain power and quash rivals. For some officers their apparent arrogance is not an inherent characteristic but a cultivated weapon used in the maintenance of departmental influence. As Heclo and Wildavsky have pointed out with respect to the British Treasury:

if the spending departments were the ultimate experts it would be difficult for the Treasury to argue with them. The Treasury, therefore, must claim to have a special expertise that belongs to no special department.... Only by fortifying themselves with this belief can the several dozen supply division officials venture forth to tilt against the massed expertise of the departments.... Treasury men know that without it they are at the mercy of departments forever wanting more money. 29

Such comments are equally applicable to the Australian counterpart.

It would seem that the Treasury consciously encourages cohesion. It does this in a number of ways. First, it carefully selects recruits from leading universities and by a screening process attempts to choose individuals likely to accept the department's outlook and mores. Second, it does not rotate recruits because, as Megan Stoyles points out: 'It believes that the graduate will be of more use to the Department if given a specific job to do and that the graduate will develop a "Treasury spirit" sooner if he feels he is doing a professional job in one sphere.' Third, it does not tolerate rebels. Internal critics have tended to move to other departments, or to overseas Treasury postings, or have joined international organisations. An ex-Treasury officer, in evidence before the RCAGA, declared that GFEP 'cultivates a certain conservative approach to economic thinking. It has no place in its organization for anybody who doesn't meet these sorts of tests, no matter how good they are.' The meaning of

30 Geoffrey Hawker, R.F.I. Smith & Patrick Weller, Politics and Policy in Australia, (University of Queensland Press, St. Lucia, 1979), p. 126. However, Frederick Wheeler, in evidence before the RCAGA, argued that: 'I do not in any way accept that there is a doctrinal attitude to which you must conform before you can get entrance to Treasury. It is demonstrably not so.' Quoted in Patrick Weller and James Cutt, Treasury Control in Australia, (Ian Novak, Sydney, 1976), p. 44.


33 Quoted in RCAGA, Interviews on Treasury Controls, Research Paper (Special Collections), No. 60, (microfiche, Monash University), Interview 1, para. 79.
Table 2.1: Third Division Salary Increases Within 4 Years and 8 Years of Joining, as at June 1974

<table>
<thead>
<tr>
<th></th>
<th>Public Service Board</th>
<th>Treasury</th>
<th>Service Overall (excluding PMG)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>N=432</td>
<td>N=702</td>
<td>N=38,291</td>
</tr>
<tr>
<td>After 4 Years</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Up to 40%</td>
<td>24.4</td>
<td>25.7</td>
<td>36.3</td>
</tr>
<tr>
<td>40%-80%</td>
<td>35.4</td>
<td>36.2</td>
<td>38.7</td>
</tr>
<tr>
<td>80% plus</td>
<td>40.2</td>
<td>38.1</td>
<td>25.0</td>
</tr>
<tr>
<td>N=299</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>After 8 Years</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Up to 80%</td>
<td>24.8</td>
<td>25.6</td>
<td>37.6</td>
</tr>
<tr>
<td>80%-120%</td>
<td>32.5</td>
<td>22.7</td>
<td>27.7</td>
</tr>
<tr>
<td>120% plus</td>
<td>42.7</td>
<td>51.7</td>
<td>34.7</td>
</tr>
</tbody>
</table>


Table 2.2: Second Division Career Service - Number of Departments Served In

<table>
<thead>
<tr>
<th></th>
<th>Public Service Board</th>
<th>Treasury</th>
<th>Service Overall (excluding PMG)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>N=9</td>
<td>N=37</td>
<td>N=548</td>
</tr>
<tr>
<td>One</td>
<td>6</td>
<td>83.8</td>
<td>57.8</td>
</tr>
<tr>
<td>Two</td>
<td>2</td>
<td>16.2</td>
<td>26.3</td>
</tr>
<tr>
<td>Three or more</td>
<td>1</td>
<td>..</td>
<td>15.9</td>
</tr>
</tbody>
</table>

Source: As for Table 2.1.
Note: The Table is based upon responses to a career service survey instigated by the RCAGA in 1974.
'conservative' is of course open to debate, but the important point is the clear suggestion that compliance with a particular outlook is an essential ingredient in achieving success in the Treasury, or at least in the policy advising divisions. Fourth, there is a financial inducement for recruits to stay with the department. As can be seen in Table 2.1, the Treasury rewards its officers particularly well by comparison with the Public Service overall. Fifth, promotion in the upper echelons of the department is normally an internal affair. Table 2.2 shows that a notably high percentage of Treasury officers have served only in that department. Such officers can be expected to have thoroughly accepted and internalised Treasury attitudes and canons of conduct and to be concerned that recruits develop and display a similar temperament.

These considerations are of relevance in understanding the apparent unity the Treasury displays in the field of economic advice. The department has often been criticised for presenting a single line of advice on matters of economic policy. Weller and Cutt, for example, argue that: 'The Treasury has the reputation for giving the advice it considers to be correct, regardless of the known policy preferences of ministers and, indeed, sometimes sticking to those views long after an alternative strategy has been adopted by a government.' Similarly, Bruce Juddery has pointed out that:

The Treasury's concept of 'objectivity' in giving advice usually means the recommendation of the single 'best' course, no matter what its political practicability, on a take-it-or-leave-it basis. Most Treasury submissions to Cabinet boil down to a single proposal. Even its papers discussing issues - such as the memorandum on the questions Ministers must be prepared to field when several of them visited Tokyo in 1973 - carefully

34 Weller and Cutt, Treasury Control, p. 98.
shepherd the reader in the direction of a single set of conclusions.35

The Treasury's tenacity in pursuing a single line of advice was clearly demonstrated in both 1971 and 1974. The 1971 budget speech, reflecting Treasury advice, argued that the central problem facing the economy was demand inflation. It claimed that the problem was likely to worsen, if left unattended, because of an apparent increase in consumer spending. William McMahon, who was then Prime Minister, has since claimed that he had 'grave reservations' about whether demand would in fact continue to rise. In September 1971 (the budget was in August), he convened a meeting with the Reserve Bank and Treasury 'with the intention of persuading [them] that a strong stimulus to demand was necessary by both fiscal and monetary policy'. McMahon notes that: 'At the first joint discussions, both strongly disagreed with me. At a second officers' meeting [in October] Reserve agreed with me and monetary policy was immediately and progressively eased.' The Treasury, however, stalled for a change in the government's fiscal policy stance until April 1972. McMahon argues that this delay 'lost us the election [of December 1972]' 36. It is perhaps not surprising that McMahon later complained to the RCAGA that the Treasury was convinced that it had 'all the answers' and that it was exceptionally difficult to convince the department that it had made mistakes.37


37 'Treasury Gave Wrong Advice, says McMahon', Sydney Morning Herald, 7 December 1974.
The fact that a Prime Minister should have to convince a department of errors and that he should have to try to 'persuade' it about the course economic policy should take, is testimony to the Treasury's strength, persistence and doggedness. It also lays to rest the myth of the Westminster system and seriously calls into question the claim of Frederick Wheeler that 'it is nonsense to imagine that there is an identifiable Treasury view on economic theory and principles', 38 and that of Frank Crean, Labor Treasurer 1972-75, that: 'There is no Treasury view, there is only a Treasurer's view.' 39

Another good example of the Treasury's determination to see that its single line of advice was accepted occurred in 1974. One observer described the behaviour of the department in the following terms:

Treasury weakened its own influence with the Labor Government not because its advice was often unpalatable but because it was always monolithic. Treasury refused to set out the economic options available to the politicians. It presented its advice on an all-or-nothing, take-it-or-leave-it basis. If its first advice was rejected, Treasury volunteered no other. If Cabinet persisted in rejecting the original advice, some Treasury officials then used their contacts with other departments, the press, business, and Opposition spokesmen, to build support for its line. 40

The advice proffered by Treasury to the Labor Government was the now famous 'short, sharp shock' strategy which aimed, by a series of deflationary measures, to combat inflation by raising unemployment. The strategy was first put forward in July 1974 at a meeting of senior Cabinet members. The

38 Quoted in Weller and Cutt, Treasury Control, p. 44.
kitchen cabinet, as it was known, initially accepted the Treasury's proposals. However, full Cabinet, and later Caucus, rejected them, believing them to be economically irresponsible and morally reprehensible. The Treasury apparently took no heed of this rejection and in August 1974 recommended a budget strategy along the lines of its earlier short, sharp shock proposals. Amidst growing concern that cost, rather than demand, pressures were the chief economic problem, the department suggested a tax increase of $400 million and a reduction in government expenditure of $600 million which, it claimed, would result in an overall deficit of around $250 million and a domestic surplus of around $320 million. 41 Hawker, Smith and Weller, in an analysis of the Treasury's confidential submissions to the 1974 budget cabinet, point out that:

In the submissions there was no attempt to discuss the issues that had been debated in the previous months. Treasury's only concession to the idea that demand inflation might no longer be the main problem was to suggest that an increase in expenditure would 'restimulate demand pressures'; in the draft [submission written earlier in August] it suggested an increase would 'sustain' them. Otherwise it treated alternative economic strategies with contempt and dismissed them in a line. For instance, Economic Situation and Prospects [one of the main Treasury submissions] declared that inflation was the major problem and then stated: 'There is another viewpoint. That is that over-full employment must be maintained all of the time.' There was little recognition of the fact that alternative strategies might have some value; the submissions provided a blanket dismissal of ideas which, after all, had the support of caucus and of a substantial section of cabinet. 42

The method of presenting a single set of options is not restricted to the Treasury; it is a common bureaucratic ploy. The rationale for the

41 Relations with the Treasury became particularly strained when it was pointed out to the budget cabinet that the department's figures were misleading and that in fact its proposals would probably lead to a domestic surplus of around $1,320 million.

42 Hawker, Smith and Weller, Politics and Policy, p. 263.
ploy has been neatly described by Hawker, Smith and Weller: 'To show alternatives is to invite debate; to admit weaknesses encourages rejection; to highlight the less welcome alternatives is tactically unwise.' It does not always follow, however, that the strategy of discounting options is a necessary preliminary to gaining influence and acceptance. The strategy can sometimes backfire, as the Treasury discovered during the Whitlam years. When advice is offered on a take-it-or-leave-it basis, there is always the possibility that it will indeed be left.

Another consideration is that it does not always follow that the department which presents a single piece of advice is necessarily a united department. While it is true that the Treasury is a highly cohesive department, it is not monolithic; disagreements do occur. It has been argued, for example, that the Treasury was split in 1971 on its ideas concerning the budget strategy. It is difficult, however, to ascertain the extent of disagreement which arose. It is difficult also to discover who the principal antagonists were - some reports suggest that the quarrel was between the younger and the senior officers engaged in policy advice. What is interesting, however, is that at no stage was McMahon aware that the Treasury was divided. He argues that:

At the time the Budget strategy was developed, senior policy advisers including the then Permanent Secretary and the Financial and Economic Policy Division of Treasury put this view [that it was essential to contain burgeoning demand pressures] with an intensity I had not previously known. I personally tested the responsible officers to ascertain whether there was any difference of opinion within Treasury. I could not find any.... No Treasury official to my knowledge argued that unemployment would reduce the rate of inflation although it might have been argued at the lower echelons. 44

43 Ibid., p. 265.
44 McMahon, 'PM versus the Bureaucrats'.

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The notable feature of this episode was not that it demonstrated the inevitable disagreements which occur in all organisations but that it revealed the high premium which the department places on loyalty, on maintaining a united front, on keeping differences private.

A corollary of the emphasis placed on loyalty is the scorn accorded to those who leave the department. Paul Kelly has observed that: 'In Canberra, leaving the Treasury is as significant as crossing the Rubicon. Those who make the journey are not likely to come back and, according to Canberra mythology, the Treasury will never forgive a senior officer who deserts.' The senior officer who leaves is resented, indeed vilified, because he creates a chink in the department's armour - he becomes an informant, letting others into the Treasury's secrets, sharing the department's knowledge, providing an insight into the department's methods, tactics and strategies.

But despite the value attached to loyalty, despite the need for unity to ensure the continuation of power, despite the conscious efforts to cultivate cohesion, disagreements, as noted, do occur within the department. The main theme of this study, that the Treasury's underlying model has changed in the post-war period, is an acknowledgement of the fact that the Treasury is not monolithic. Such change implies an element of disagreement; it implies the rejection of old interpretations and the injection of new ones. However, viewed from the broad sweep of post-war


46 Change can of course occur in unison; what is being suggested is that disagreement is usually the agent of change.
history the changes which have occurred have been gradual. Given this fact and given the relative cohesion of the department, it seems reasonable to conclude that one can make generalisations about the dominant features of Treasury thought at any particular point of time.
The central argument of this study, that Treasury thought has undergone a gradual, but distinct, change in outlook from a predominantly Keynesian model to a predominantly neoclassical model, raises important definitional problems. What is meant by 'Keynesian' model? What is meant by 'neoclassical' model? Are the two mutually exclusive? Given that the aim of Parts and Three is to trace the transition in Treasury thought from Keynesianism to neoclassicism, it is imperative to outline in detail the meaning of these terms. This is the purpose of the present chapter. It looks first at the neoclassical model and then at that of Keynes. It concludes by examining how the two models have been synthesised in the post-war period.

It should be stressed at the outset that the neoclassical model, as described here, is a construct. It is a composite made up of the views of a diverse group of writers, representing different social backgrounds, different nationalities and different eras. It is assumed that out of this diversity a common essence can nevertheless be distilled. Thus, although certain differences are highlighted, the picture presented is one of fundamental unity. Similarly, the Keynesian model may be described as a construct in that although it deals with the writings of only one man it is based mostly on Keynes's post-1930 writings and thereby glosses over his early Marshallian views. Again, the discussion of post-war Keynesianism focuses on Hicks and Samuelson and fails to discuss the alternative ways in which neoclassicism and Keynesianism have been synthesised. In brief, it is acknowledged that the various models described herein involve some distortion and simplification. It must be kept in mind, however, that the
purpose of the models is not to provide a detailed history of the ideas of individual economic theorists but to provide a perspective with which to analyse Treasury thought. The neoclassical and Keynesian models have been described with the aim of providing benchmarks with which to facilitate the exposition in Part Three. The models enable the researcher to probe 'beneath' Treasury documents and to see how there has been a distinct transformation in the department's outlook. They thereby provide a means of obtaining a deeper understanding of the department than that provided by the alternative of descriptivism. This, hopefully, will anticipate potential criticism of the models for not being totally representative of the writers mentioned.

The Neoclassical Model

Neoclassical economics produces neoclassical models, but perhaps not so much because the world works in a neoclassical way as because the minds of officially trained and approved economists work in a neoclassical way.

- Benjamin Ward, 1972

The neoclassical model is essentially mechanistic and reflects the continuing influence of the Newtonian (Enlightenment) world-view. Both Jevons and Walras supported enthusiastically the idea of modelling economics on classical mechanics. Jevons noted in the preface to the first edition of his *Theory of Political Economy* that: 'The theory of economy thus treated, presents a close analogy to the science of statical

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mechanics, and the laws of exchange are found to resemble the laws of
equilibrium of a lever as determined by the principle of virtual
velocities. ¹ Walras envisaged a day when 'mathematical economics will
rank with the mathematical sciences of astronomy and mechanics'. ² He
argued that 'the pure theory of economics or the theory of exchange and
value in exchange, that is, the theory of social wealth considered by
itself, is a physico-mathematical science like mechanics or
hydrodynamics'. ³ Marshall was not as enthusiastic about the use of
mechanistic models. To him, the Mecca of the economist lay in biology.⁴
However, he was willing to indulge in mechanistic analogies as a necessary
first step in understanding: mechanistic analogies, being less complex
than those drawn from biology, were considered appropriate for an
introductory volume such as his Principles of Economics.⁵ In the post-war
period, as will be argued in more detail later, the mechanistic basis of
neoclassical economics has persisted and, quite possibly, gathered strength
- particularly as a result of the mathematisation of economics. What

² W.S. Jevons, The Theory of Political Economy, (1871), (Penguin,
Harmondsworth, 1970), p. 44.

³ Léon Walras, Elements of Pure Economics or the Theory of Social Wealth
(1874), Edition Définitive (1926), trans. William Jaffé, (Richard D.
Irwin, Homewood, 1954), p. 48. The quotation is from the preface to
the fourth edition (1900). Walras continued: 'and on that day
justice will be done to our work'.

⁴ Ibid., p. 71.

⁵ Alfred Marshall, Principles of Economics: An Introductory Volume,
Marshall, 'Mechanical and Biological Analogies in Economics', in
1925), p. 318. This article is an extract from Alfred Marshall,

⁶ Marshall, Principles, p. xiv. See also Marshall, 'Mechanical and
Biological Analogies', pp. 317-18.
Marshall took to be a useful analogy, a pedagogical device, a way of penetrating the complexities of real life, has been promoted to the status of actuality: equilibrium tendencies operating in mechanistic fashion are not only a way of understanding reality but are reality. The Walrasian ideal has been placed on a pedestal. Marshall's Mecca has been shunned.

The mechanistic basis of the neoclassical model is revealed most clearly in its preoccupation with the notion of equilibrium. Equilibrium is central to the neoclassicist's interpretation. The neoclassicist contends that beneath the apparent confusion and indeterminancy of daily experience and existence there exists an underlying logic, a sense of order, a determinate, purposive process, a unifying force. The underlying logic is expressed in terms of an inherent tendency toward equilibrium - equilibrium being a state of affairs where utility and profits are maximised and where markets clear. It is an optimal point, a chosen position. It is where both consumers and producers want to be. Hence it may be characterised as a state of rest, a situation no economic agent would want to alter or abandon.

Equilibrium is assumed to be stable. As described by Marshall,

if any accident should move the scale of production from its equilibrium position, there will be instantly brought into play forces tending to push it back to that position; just as if a stone hanging by a string is displaced from its equilibrium position, the force of gravity will at once tend to bring it back to its equilibrium position. The movements of the scale of production about its position of equilibrium will be of a somewhat similar kind.7

To Marshall, positions of unstable equilibria were at best theoretical

possibilities.\textsuperscript{8}

The process Marshall discerned in his analysis of individual markets, Walras discerned in the economic system as a whole. The crux of the Walrasian position is that the diverse elements of the entire system tend unceasingly toward a point of general equilibrium which, because of the passage of time and because of market imperfections, is never actually attained:

Equilibrium in production, like equilibrium in exchange, is an ideal and not a real state. It never happens in the real world that the selling price of any given product is absolutely equal to the cost of the productive services that enter into that product, or that the effective demand and supply of services or products are absolutely equal. Yet equilibrium is the normal state, in the sense that it is the state towards which things spontaneously tend under a régime of free competition in exchange and production. In fact, under free competition, if the selling price of a product exceeds the cost of the productive services for certain firms and a profit results, entrepreneurs will flow towards this branch of production or expand their output, so that the quantity of the product [on the market] will increase, its price will fall, and the difference between price and cost will be reduced; and, if [on the contrary], the cost of the productive services exceeds the selling price for certain firms, so that a loss results, entrepreneurs will leave this branch of production or curtail their output, so that the quantity of the product [on the market] will decrease, its price will rise and the difference between price and cost will again be reduced.\textsuperscript{9}

In this passage and in Marshall's definition of stable equilibrium, the Newtonian underpinnings of the neoclassical model can be seen clearly. As with Newton, the vision is essentially one of order, harmony

\textsuperscript{8} He claimed that positions of unstable equilibria 'are the dividing boundaries between two positions of stable equilibria, the watersheds, so to speak, dividing two river basins, and the price tends to flow away from them in either direction'. \textit{Ibid.}, p. 806n.

\textsuperscript{9} Walras, \textit{Elements}, pp. 224-5; emphasis added; words in square brackets added by translator.
and determinancy. The economic system is like the Laplacean celestial clockwork in which all the parts, interrelated and interdependent, combine to form a smoothly functioning and efficient machine. The system is self-adjusting: it tends 'spontaneously' and predictably toward an optimum point. Just as the planets are held in place by gravity so too do economic units gravitate toward a position of equilibrium. Inherent and irresistible forces ensure that displacement from the equilibrium path is only a temporary aberration. As Solo puts it: 'Equilibrium is the end point of all tendencies, and that which perpetually pulls all straying elements in its direction is the cosmic glue that coheres and patterns the whole economic universe.'

In the neoclassical model it is self-interest which acts as the gravitational force. Self-interest propels the system and ensures that the system is self-regulating. Consumers are assumed to be utility maximisers and firms profit maximisers. Economic agents, taking their cue from price signals, attempt to achieve a subjectively determined optimal position. Thus, Walras argued, as noted, that if a firm is making a loss then it will either decrease output or begin producing something else. The firm, like all economic agents, will not ignore price signals and will not allow costs to run ahead of prices. It will take whatever action is necessary to maximise profits.

Underpinning Walras's argument was the assumption that decision-making is an individual exercise. This assumption reflects the neoclassicist's atomistic outlook. Whereas the Marxist focuses primarily

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on class relations, the neoclassicist concentrates on the individual. It
is postulated that the relations between economic agents are external to
the decision-making process. The economic agent is assumed to be an
autonomous entity, a self-determining being. Group decisions and actions
are merely the sum of individual decisions and actions.

Decision-making, according to the neoclassical model, is exercised
calmly, dispassionately. Economic agents are essentially calculative
creatures. Pursuing the goal of maximisation they weigh up carefully the
costs and benefits of alternative actions. Thus if a firm or industry
experiences a loss, as in Walras's example, that loss need not become
cumulative. There is no reason why it should start a wave of pessimism.
The atomistic decision-maker will interpret the loss merely as an
indication that output schedules have to be revised or that profits can be
made elsewhere. Economic decision-makers will not panic; they will
continue to do that which is commensurate with the goal of maximisation.

The calculative characteristic of economic agents was stressed by
Marshall.\footnote{11} The dominant characteristics of industrial life, in his view,
were 'a certain independence and habit of choosing one's own course for
oneself, a self-reliance; a deliberation and yet a promptness of choice and
judgement, and a habit of forecasting the future and of shaping one's
course with reference to distant aims.... It is deliberateness and not
selfishness that is the characteristic of the modern age.'\footnote{12} He qualified

\footnote{11} For an excellent account of Marshall's image of man, see Walter A.
Weisskopf, The Psychology of Economics, (Routledge & Kegan Paul,
London, 1955), Part 5, particularly Ch. 15.

\footnote{12} Marshall, Principles, pp. 5, 6.
this by noting that 'it is not to be supposed that we assume every action to be deliberate, and the outcome of calculation ... in ordinary life people do not weigh beforehand the results of every action'. But the sorts of activities which dominated economic life were those 'in which man's conduct is most deliberate, and in which he most often reckons up the advantages and disadvantages of any particular action before he enters on it'. Even when decisions in the economic sphere were in accordance with habits and customs and were taken seemingly without calculation, 'the habits and customs themselves are most nearly sure to have arisen from a close and careful watching the advantages and disadvantages of different courses of action'.

Thus, while Marshall was aware of the forces of habit and instinct, he abstracted from the possibility of irrational conduct by claiming that such forces were based on earlier calculative behaviour. Similarly, although he was aware of people of 'wayward temperament', his attention was focused on the man who is 'steadfast and thoughtful'. Likewise, he restricted his analysis to the actions of so-called prudent people, passing over those who lacked such prudence. That which had a tinge of irrationality was not considered. Economic agents, it was implied, were fundamentally and predominantly rational beings.

Rationality was equated with calculative, maximising behaviour. All economic agents, whether they be housewives, businessmen, builders,
clerks, young couples or farmers, were assumed to be striving for
maximisation. The primitive housewife, for example, 'finding that she has
a limited number of hanks of yarn from the year's shearing, considers all
the domestic wants for clothing and tries to distribute the yarn between
them in such a way as to contribute as much as possible to the family
wellbeing'.

The young couple, to provide another example, finding that
they have to reduce their expenditure, 'compare the (marginal) utilities of
different items, weighing the loss of utility that would result from taking
away a pound's expenditure here, with that which they would lose by taking
it away there; they strive to adjust their parings down so that the
aggregate loss of utility that remains to them may be a maximum'.
The businessman, similarly, 'will push the investment of capital in his
business in each several direction until what appears in his judgement to
be the outer limit, or margin, of profitableness is reached; that is, until
there seems to him no good reason for thinking that the gains resulting
from any further investment in that particular direction would compensate
him for his outlay'.

In each instance, the economic agent, faced with
limited resources (the scarcity constraint), attempts to maximise utility
or profits. All act rationally: it is a prime characteristic of the
rational or prudent person that he 'will endeavour to distribute his means
between all their various uses, present and future, in such a way that they
will have in each the same marginal utility'.

\[16\] Ibid., p. 117.
\[17\] Ibid., p. 119.
\[18\] Ibid., p. 356.
\[19\] Ibid., p. 119.
process involves deliberate calculation can be seen clearly in the above examples. Economic agents pursue the goal of maximisation carefully, consciously, in a step by step manner, weighing up the advantages and disadvantages of different courses of action.  

The belief that economic agents are fundamentally rational creatures continues to underpin modern neoclassical theorising. Defining rational behaviour, as McClelland points out, usually involves blending together two assertions. The first assertion relates to how decisions are made. It is assumed that each economic agent has preferences which he or she can rank or order over an entire field of choice. (This differentiating process does not preclude the possibility that some preferences can be ranked equally.) It is further assumed that the agent is consistent in his ordering of preferences. Thus if A is preferred to B, and B is preferred to C, then the rational economic agent prefers A to C. The second assertion relates to the objectives of the economic agent. It is assumed that each individual prefers more to less. Human wants are believed to be insatiable.

The image of man emerging from this interpretation of rationality is essentially Marshallian, though in skeletal form. Man continues to be

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20 As Marshall explained with regard to the primitive housewife, the maximisation process involves 'first decisions as to the relative urgency of various ends; secondly, decisions as to the relative advantages of various means of attaining each end; thirdly, decisions, based on these two sets of decisions, as to the margin up to which she could most profitably carry the application of each means towards each end'. *Ibid.*, p. 357.

seen as a deliberating, calculating, teleologically-directed being. Since Marshall's day, however, there has been a much greater willingness to label this image an abstraction. The assumptions made about human rationality, it is argued, are simplifying techniques. Economic Man is a device for isolating tendencies apparent in the real world; it is a necessary first step in understanding the complexities of daily experience.²² By contrast, Marshall's portraits of the primitive housewife, the young couple and the businessman constituted what he took to be reality - there was, as far as he was concerned, no abstraction involved.²³

Another departure from the Marshallian tradition concerns the ethical content of rational decision-making. Marshall's comments on decision-making were permeated with Victorian presuppositions, ideals and ethics as to 'appropriate' economic behaviour. His image of man was both an interpretation and an ideal based on Victorian virtue. Post-Marshallian neoclassicism, by contrast, has taken a much more value-passive approach to maximising behaviour - the individual may follow whatever ethics he or she wants.²⁴ Robbins, for example, could claim in 1932 that 'our economic subjects can be pure egoists, pure altruists, pure ascetics, pure sensualists or - what is much more likely - mixed bundles of all these


²³ Weisskopf refers to 'how seriously Marshall took the ideal of the rational, deliberate man. To him it is by no means a hypothetical construct used to arrive at determinate, predictable equilibrium solutions. Conscious, deliberate calculation is considered a virtue, an obligation.' Weisskopf, Psychology of Economics, p. 164.

impulses'. 25 But in harmony with Marshall it continues to be assumed that whatever the mainsprings of action, economic agents have the common characteristics of deliberation, calculation and ordering. As such, neoclassicism cannot be judged to be value-free.

Robbins's claim highlights an important element of the neoclassical model: the neoclassicist is not concerned with why people act, being contented to note that people do act. He is not concerned with motives, only with results. 26 He is content to postulate that people have preferences which they rank in a consistent manner. As Robbins has argued:

Why the human animal attaches particular values ... to particular things, is a question which we do not discuss. That is quite properly a question for the psychologists. All that we need to assume: as economists is the obvious fact that different possibilities offer different incentives, and that these incentives can be arranged in order of their intensity. 27

Boulding has suggested that the economist is not really concerned with the world of men but with the world of commodities. 28 This judgement is certainly applicable to the neoclassicist. The assumptions upon which

25 Robbins, Essay, p. 95.

26 As Marshall put it: 'the economist studies mental states rather through their manifestations than in themselves'. The study of whether actions were the result of a person's 'higher' or 'lower' nature was in the domain of the philosopher (nowadays, the psychologist). Marshall, Principles, p. 16.

27 Robbins, Essay, p. 86. Robbins went on to repeat the point: 'The fundamental concept of economic analysis is the idea of relative valuations; and ... while we assume that different goods have different values at different margins, we do not regard it as part of our problem to explain why these particular valuations exist. We take them as data.' Ibid., pp. 94-5.

The neoclassicist's model of perfect competition is based tend to abstract from the individual decision-maker. Attention centres instead on the role of prices in effecting changes in consumption and exchange. General equilibrium theorising rests on the assumption that economic agents have perfect knowledge; uncertainty is assumed to be absent. But as Knight has pointed out, 'with uncertainty absent ... it is doubtful whether intelligence itself would exist in such a situation; in a world so built that perfect knowledge was theoretically possible, it seems likely that all organic readjustment would become mechanical, all organisms automata'.

Walras was aware that in a world of perfect competition economic agents could be abstracted from. Discussing the properties of general equilibrium, he noted that: 'Assuming equilibrium, we may even go so far as to abstract from entrepreneurs and simply consider the productive services as being, in a certain sense, exchanged directly for one another, instead of being exchanged first against products, and then against productive services.'

Similarly, Pareto, Walras's successor at Lausanne, argued that it was possible to obtain for each individual several indifference series for various combinations of, say, bread and wine. These indifference series, he judged, were sufficient data to determine economic equilibrium. More importantly, he contended that: "The individual can disappear, provided he leaves us this photograph of his tastes." (He continued: 'Clearly what we have said about bread and wine can be repeated...

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30 Walras, Elements, p. 225; emphasis added.
for all other goods.')\textsuperscript{31} Pareto made explicit the implication of Robbins's observation that the neoclassicist's concern with psychology extends no further than the 'obvious fact' that individuals can and do rank their preferences. Once these preferences are known the actions of the individual are no longer relevant (except for Marshall who, as noted, continued to exercise his penchant for moralising).

According to Walras: 'Pure economics is, in essence, the theory of the determination of prices under a hypothetical regime of perfectly free competition. The sum total of all things, material or immaterial, on which a price can be set because they are scarce (i.e. both useful and limited in quantity), constitutes social wealth. Hence pure economics is also the theory of social wealth.'\textsuperscript{32} Walras's definition captures two important features of the neoclassical model: the postulate of scarcity and a preoccupation with the determination of prices. Scarcity necessitates maximising behaviour: because means are limited and have alternative uses, economic agents have to make the best of what is available to them. Given that economic agents are maximisers, the question arises: how are scarce resources - goods and services - allocated between alternative uses and distributed between people? In providing an answer, the neoclassicist focuses on the price mechanism. The role of prices in allocating scarce resources is the neoclassicist's prime concern. He postulates that a decentralised (market) economy tends to allocate resources efficiently, that is, given the constraint of scarcity, a market system will tend toward


\textsuperscript{32} Walras, Elements, p.40.
an allocation of resources in which both individual and societal welfare are maximised. Prices perform a crucial role in this allocative process by providing signals for economic agents. Price signals co-ordinate the actions of individual economic agents. They indicate whether demand is exceeding supply or vice versa and they thereby act as a guide to decision-making. Prices reflect the forces of supply and demand and will move as long as imbalances between supply and demand persist.

In the neoclassical model the gravitational force in the system, self-interest, moves the system toward equilibrium via the price mechanism. In a competitive market system in which prices are allowed to adjust freely to market pressures there will be a tendency for demand and supply imbalances to be eliminated: this is the basis of the belief that the system is self-adjusting, that it tends toward equilibrium - this being, as noted, a position not only of rest but of equality between supply and demand.

The neoclassicist's image of man underpins the emphasis given to the role of prices. The efficacy accorded to the price system in producing a tendency toward the elimination of imbalances between supply and demand rests on the assumption that economic agents are in fact the rational, maximising creatures they are assumed to be: to attach central importance to changes in relative prices as a determinant of economic behaviour is to imply that economic agents are essentially calculative beings.

The neoclassicist postulates that if imbalances between supply and demand appear to be persisting, as in the labour market in the 1930s, then there must be rigidities in the system which are hampering the operation of the price mechanism. To take the case of the labour market, it is assumed that in a market economy there will be an inherent tendency toward full
employment (this being the equilibrium point where demand for labour equals supply) provided that the price of labour (the real wage rate) is allowed to adjust unhindered to variations in supply and demand. Competition in the labour market will ensure that real wages are driven toward the equilibrium point. Thus, prolonged unemployment indicates that real wages are somehow being maintained at levels which are too high: they are above the equilibrium wage point. This in turn indicates that competition is being constrained - most probably by monopolistic trade unions unwilling to accept a decline in the real wages of their members, but also possibly by governmental subsidies and other protective measures and particularly by minimum wage and dole legislation, as well as by, in the Australian case, the actions of the Conciliation and Arbitration Commission and other wages boards. In short, unemployment in the neoclassical model is essentially a result of inflexible wage practices. As Robbins argued in 1934 in the midst of the Great Depression: 'in general it is true to say that a greater flexibility of wage rates would considerably reduce unemployment'. He continued: 'if it had not been for the prevalence of the view that wage rates must at all costs be maintained in order to maintain the purchasing power of the consumer, the violence of the present depression and the magnitude of the unemployment which has accompanied it would have been considerably less'.

The concept of flexibility features prominently in the neoclassical model. The more flexible are prices and the more mobile are the factors of production, particularly labour, then the smoother and the closer will the

system approach equilibrium. Economic efficiency is considered dependent upon correct pricing signals and appropriate responses to signals. That which hinders either signal or response is anathema. Monopolistic practices thus invite disdain.

The emphasis in the neoclassical model upon flexibility is embodied in Marshall's principle of substitution. The substitution principle is at the base of Marshall's belief that: 'If a person has a thing which he can put to several uses, he will distribute it among these uses in such a way that it has the same marginal utility in all. For if he had a greater marginal utility in one use than another, he would gain by taking away some of it from the second use and applying it to the first.' The same principle is operating in Walras's claim that faced with a loss a firm will either decrease output or switch production to something more profitable. The idea of equilibrium through maximisation is dependent upon the principle of substitution. It is dependent also on the notion of competitive markets. For competition is seen to be conducive to flexibility, mobility and substitution.

In summary: the neoclassical model is essentially mechanistic. Rational, calculating, maximising economic agents propel the system toward equilibrium - this being a situation characterised by rest and by the equality of supply and demand. Equilibrium is never actually attained but the system tends unceasingly toward it. Relative price movements are of prime importance in allocating resources and moving the system toward

equilibrium. The stability and efficiency of the system is a function of the extent to which prices are able to move unhindered in response to changing market conditions and of the extent to which economic agents adjust their consumption and production patterns in response to price signals. The more flexible the system and the greater the degree of substitution, the smoother will the system function. The neoclassicist is not interested in human behaviour as such. He is content to postulate that individuals have preferences which they rank. The neoclassicist's main interest is with equilibrium states, with the formation of prices, and with the allocative process.

The influence of the Enlightenment upon the model is indicated, as noted, by the adoption of a mechanistic viewpoint and by the use of mechanistic metaphors - demonstrated most clearly by the importance attached to the concept of equilibrium. The effect of the Enlightenment is evident also in the presupposition that the world is characterised by orderliness, regularity and determinancy (which is at the basis of the belief that there is an inherent, natural, and unceasing tendency toward the elimination of imbalances between supply and demand), as well as by universality, particularly with regard to human nature (all economic agents are assumed to be rational - a belief in Reason was of course a defining characteristic of the Enlightenment - and it is proudly proclaimed that the psychological presuppositions of neoclassicism are drawn from everyday experience,[^36] are 'obvious facts', and hence, by implication, apply to

[^36]: "[Postulates, such as] the fact that individuals can arrange their preferences in an order, and in fact do so [...] ... are so much the stuff of our everyday experience that they have only to be stated to be recognised as obvious'. Robbins, Essay, pp. 78-9.
The neoclassical model has inherited also the cognitive ideals of the Enlightenment. These ideals have been described by Berlin: 'All genuine questions were questions of discoverable fact - calculemus, Condorcet declared, was to be the motto of the new method; all problems must be so reformulated that inspection of the facts - aided by mathematical techniques - would answer them decisively, with a clear, universally valid, empirical statement of verifiable fact.' This particular epistemology, now labelled positivism, has had a profound influence upon the development of Western thought. The perceived methods of classical physics have acted as model not just for other natural sciences but, in varying degrees, for all social sciences, notably economics. The positivist advocates the collection and refinement of data, the discovery of correlations and the formulation of testable empirical generalisations, hypotheses and models. But more than this, he insists that scientific explanation is fundamentally the discovery of law-like statements. That which cannot be expressed in scientific language is not worthy of consideration. The positivist, as described by Murphy, 'sees

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37 Robbins, commenting on the assumption made by economists that different possibilities offer different incentives which can be arranged in order of their intensity, concluded: 'Here, as so often, the founders of Economic Science constructed something more universal [sic] in its application than anything that they themselves claimed.' Robbins, Essay, p. 86.


39 For an outline of the development of positivism, see L. Kolakowski, Positivist Philosophy, (Penguin, Harmondsworth, 1972).

social facts as given within the natural order, perceivable and verifiable intersubjectively and possessing an autonomy and existence of their own. They are describable and quantifiable by their positive attributes, and they are authoritative - one does not question the facts.41

Since World War II, consequent upon the mathematisation of economics, the positivistic underpinnings of the neoclassical model have become more deeply entrenched. By 1971, Leontief, himself one of the leaders of mathematical economics, could refer to the 'nearly mandatory use by economic theorists of mathematics'. 'Professional journals', he noted, 'have opened wide their pages to papers written in mathematical language; graduate schools require its knowledge and reward its use.'42 Within the economics profession 'The Age of Econometrics' rather than 'The Age of Keynes' is perhaps the more accurate epithet with which to characterise the post-war period.

The mathematisation of economics has exacerbated an underlying tension in the positivistic stance. On the one hand, with his emphasis on the collection of observable and quantifiable facts, the positivist is apparently concerned with generating empirical data with which to plot the dimensions of the real world. On the other hand, the positivist's attempts at formulating nomological statements and hypotheses can lead to a level of abstraction in which the real world is lost sight of. Thus although both


Walras and Marshall adopted a positivistic outlook, Schumpeter was correct when he observed that 'Walras] was bent on scraping off everything he did not consider essential to his theoretical schema [while] Marshall, following the English tradition, was bent on salvaging every bit of real life he could possibly leave in'. The increased use of mathematics has encouraged the Walrasian tendency toward abstraction and simplification. That which can be quantified is emphasised - one can only slot into an equation that which is expressed in numerical terms. The world is reduced to a system of equations and becomes, to use Simmel's phrase, 'a huge arithmetical problem'. Having interpreted the world this way, the mathematical economist may become concerned not with the collection of data but solely with manipulation. Interest lies in solving a particular puzzle not with deciding whether the puzzle is of relevance. With virtuosity rather than relevance at stake, that which becomes of prime importance to the mathematical economist is the internal consistency of the model not the accuracy of the assumptions upon which it is based. Thus, for all their complex equations, mathematical models may nevertheless present a highly abstract, stylised and simplified view of the world. This of course is not to say that all mathematical economists operate this way. But according to


44 Simmel refers to that type of individual whose 'cognitive ideal is to conceive of the world as a huge arithmetical problem, to conceive events and the quantitative distinction of things as a system of numbers'. See George Simmel, The Philosophy of Money (1900), trans. Tom Bottomore and David Frisby, (Routledge & Kegan Paul, London, 1978), p. 444.
several prominent econometricians it is a common proclivity. 45

Finally, what is the role of government in the neoclassical schema? Neoclassicism is commonly associated with a laissez-faire stance toward the role of government. Given that the system is considered self-adjusting, a minimum of state intervention is advocated. Government intervention is considered ultimately impotent in the face of inherent and inevitable self-adjusting tendencies. To interfere with such tendencies would succeed only in prolonging the day of reckoning - it would serve merely to lengthen and exacerbate the adjustment process and hence to make it more costly. The government, it is claimed, can only affect the conditions in which the economy operates, it cannot alter the economy's natural tendencies. It is argued that intervention of a purposive, discretionary type will (more than likely) hamper the operation of the economy by upsetting the calculations of rational businessmen. However, neoclassicists (particularly those of monetarist persuasion) 46 depart from strict laissez-faire in that they favour rule-setting government intervention designed to promote a more stable and more competitive environment within which economic activity can operate. 47 Thus, antimonopolistic legislation is welcomed. Monetarists argue for legislation


46 See the appendix to this chapter for a discussion of the relationship between monetarism and neoclassicism.

to fix the rate of change in the money supply. Support is given to de-regulation and to reducing public sector commitments and activities which, it is argued, will give more scope to private enterprise. Legitimate intervention, according to the neoclassicist, should take as its criterion the scope it gives to the operation of market forces. That which unleashes market forces is judged desirable. Clearly, there are close links between the neoclassicist's vision of the economy and his views on the proper role of government.

The Keynesian Model

Keynes was convinced that his way of looking at the world was fundamentally different to that of the neoclassical orthodoxy. He considered the General Theory a revolutionary work, the culmination of 'a long struggle of escape ... from habitual modes of thought and expression', an escape

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48 See, for example, Milton Friedman, 'Should There be an Independent Monetary Authority?', in Leland B. Yeager (ed.), In Search of a Monetary Constitution (Harvard University Press, Cambridge, 1962).


50 Keynes did not use the term 'neoclassical'. He lumped Marshall, Edgeworth and Pigou together with Ricardo and James and J.S. Mill and referred to them as 'classical' economists.

from the ideas of orthodoxy 'which ramify, for those brought up as most of us have been, into every corner of our minds'.

He told German and Japanese readers of the General Theory that 'this book represents a reaction, a transition away from the English (or orthodox) tradition'.

He pointed out in 1939 in the French edition of his book that he had been brought up in the orthodoxy which had dominated English political economy for over a hundred years. He had learnt it, taught it, written it. 'But', he declared, 'I myself in writing [the General Theory], and in other recent work which has led up to it, have felt myself to be breaking away from this orthodoxy, to be in strong reaction against it, to be escaping from something, to be gaining an emancipation'.

What was the basis of the Keynesian emancipation? In what ways did Keynes's interpretation of the economic system differ from that of the neoclassicists? A key difference concerned the self-adjusting ability of the capitalist economy. The neoclassical claim was that the system had an


inherent tendency toward full employment equilibrium. Keynes rejected this. His 1934 BBC broadcast, 'Poverty in Plenty: Is the Economic System Self-Adjusting?', was an unambiguous denial of the idea of a self-regulating system. Keynes drew attention to two competing schools of thought. On the one hand were those who believed that 'the existing economic system is, in the long run, a self-adjusting system, though with creaks and groans and jerks, and interrupted by time lags, outside interferences and mistakes'. Adherents to this faith did not believe the system to be automatically or immediately self-adjusting. But they did maintain that, provided the system 'is not interfered with and if the action of change and chance is not too rapid', there was an inherent tendency leading to the elimination of imbalances between supply and demand. On the other hand was the school of thought which rejected the notion that the system was, 'in any significant sense', self-adjusting. Those who belonged to this school were 'the descendants of a long line of heretics', 'isolated groups of cranks', 'people of practical good sense'. The self-adjusting school, by contrast, had behind it 'almost the whole body of organised economic thinking and doctrine of the last hundred years' and as such was a 'formidable power'. To Keynes, the differences between these two schools were of fundamental importance. He declared: 'The gulf between these two schools of thought is deeper, I believe, than most of those on either side of it are aware of'. The 'essential truth', he argued, lay with the viewpoint of the heretics: 'I believe their flair and their instinct move them towards the right conclusion'. 55 But for Keynes

55 As early as 1932 in a 'Historical Retrospect' section which formed part of the earliest drafts of the General Theory, Keynes had supported the 'instincts of the practical men' over the self-adjustment claims of economists. Reprinted in Collected Writings, Vol. 13, p. 406.
flair and instinct were not enough. It would be 'impossible to rest satisfied' until he had discovered the 'fatal flaw' in orthodox reasoning. His task was 'to demolish the forces of nineteenth-century orthodoxy' and to demonstrate with a rigorous theoretical proof that: 'The system is not self-adjusting, and, without purposive direction, it is incapable of translating our actual poverty into our potential plenty.'

The economy, as far as Keynes was concerned, had a tendency toward instability rather than toward self-adjustment. As he explained in Chapter 18 of the General Theory (which summarised the theory), the system moves in cyclical fashion. The system was seen to be constantly fluctuating, constantly oscillating. It was prone to instability but not violent instability:

[the economic system] seems capable of remaining in a chronic condition of sub-normal activity for a considerable period without any marked tendency either towards recovery or towards complete collapse. Moreover, the evidence indicates that full, or even approximately full, employment is of rare and short-lived occurrence. Fluctuations may start briskly but seem to wear themselves out before they have proceeded to great extremes, and an intermediate situation which is neither desperate nor satisfactory is our normal lot.

Fluctuations in output and employment involved passing through a succession of phases. The economy moved in cyclical fashion through boom, crisis, slump and recovery. Though the economy was characterised as being

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57 Keynes, General Theory, pp. 249-50. He went on to argue that 'we oscillate, avoiding the gravest extremes of fluctuation in employment and in prices in both directions, round an intermediate position appreciably below full employment and appreciably above the minimum employment a decline below which would endanger life'. Ibid., p. 254.
'not violently unstable' an exception was the transition from boom to slump which 'often takes place suddenly and violently'. However, in the transition from slump to recovery to boom there was generally 'no such sharp turning point'.58 This particular transition in activity from a downward to an upward trend, characterised for the most part by the underemployment of resources, was a protracted affair and was the usual condition for the economy. It was Keynes's conviction, and this perhaps was not surprising given that he was writing in the midst of depression, that it was the 'normal thing' in modern communities 'for output to be below the optimum level'.59

But despite the persistence of suboptimal levels of economic activity, the Keynesian perspective, as noted, was essentially cyclical. One of the major weaknesses of neoclassical theory, Keynes contended, was that by subscribing to Say's 'fallacy' that supply created its own demand (which implied that the economy operated at full capacity), such theory was rendered 'wholly inapplicable', 'clearly incompetent' to deal with the problem of the trade cycle.60 The schema adopted in the General Theory

58 Ibid., p. 314.
59 Keynes, 'Historical Retrospect', p. 407. In line with this, Keynes argued in a lecture given in Chicago in 1931 that 'it is a possibility that the duration of the slump may be much more prolonged than most people are expecting.... Not, of course, the duration of the acute phase of the slump, but that of the long, dragging conditions of semi-slump, or at least subnormal prosperity which may be expected to succeed the acute phase.' J.M. Keynes, 'An Economic Analysis of Unemployment', in Q. Wright (ed.), Unemployment as a World Problem, Lectures on the Harris Foundation 1931, (University of Chicago Press, Chicago, 1931). Reprinted in Collected Writings, Vol. 13, p. 344.
was, by contrast, 'particularly relevant' to understanding this phenomena.\textsuperscript{61} Chapter 22 opened by declaring: 'Since we claim to have shown in the preceding chapters what determines the volume of employment at any time, it follows, if we are right, that our theory must be capable of explaining the phenomena of the Trade Cycle.'\textsuperscript{62} The \textit{General Theory} was not itself primarily a theory of the trade cycle. Its aim rather was to analyse the determinants of total output and employment and in so doing to emphasise the importance of effective demand. Its horizon was limited to the short-term. But Keynes was convinced that the principle of effective demand provided a firm basis for understanding cyclical fluctuations.

The inappropriateness of neoclassical theorising in investigating problems such as unemployment and the trade cycle was one of Keynes's popular themes. For example, he complained in 1933:

\begin{quote}
all our ideas about economics, instilled into us by education and atmosphere and tradition are, whether we are conscious of it or not, soaked with theoretical presuppositions which are only properly applicable to a society which is in equilibrium, with all its productive resources already employed. Many people are trying to solve the problem of unemployment with a theory which is based on the assumption that there is no unemployment.\textsuperscript{63}
\end{quote}

The same point was made, again in 1933, in an article on the need for a monetary theory of production:

\begin{quote}
the real-exchange economics, on which most of us have been
\end{quote}

\textsuperscript{61} Preface to the German Edition of the \textit{General Theory}, p. xxxiii.
\textsuperscript{62} Keynes, \textit{General Theory}, p. 313.
brought up and with the conclusions of which our minds are deeply impregnated, though a valuable abstraction in itself and perfectly valid as an intellectual conception, is a singularly blunt weapon for dealing with the problem of booms and depressions. For it has assumed the very matter under investigation. 64

Both of these passages testify to Keynes's recognition of how deeply entrenched was the orthodox vision of the economy and reveal his distaste for reasoning based on invalid premises. He believed that he was offering a quite distinct vision and method of reasoning and a more realistic theory than that provided by neoclassical orthodoxy. He did not question the logical consistency of neoclassical theory; he questioned its relevance. 65 He believed it represented a confusion between ideal-type and reality, a confusion between desideratum and actual behaviour. 66 His theory, he felt, was exempt from such confusion.

Underlying Keynes's vision of cyclical instability was a belief that each stage of the cycle - boom, crisis, slump, recovery - contained, to use a Marxist metaphor, the seeds of its own destruction. In the General Theory reference was made to the 'tendency of a fluctuation in one direction to reverse itself in due course'. 67 Further, 'even those degrees

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65 The General Theory concluded by noting: 'Our criticism of the accepted classical theory of economics has consisted not so much in finding logical flaws in its analysis as in pointing out that its tacit assumptions are seldom or never satisfied, with the result that it cannot solve the economic problems of the actual world (p. 378).'

66 'It may well be that the classical theory represents the way in which we should like our Economy to behave. But to assumed that it actually does so is to assume our difficulties away.' Keynes, General Theory, p. 34.

67 Ibid., p. 251.
of recovery and recession, which can occur within the limitations set by our other conditions of stability, will be likely, if they persist for a sufficient length of time and are not interfered with by changes in the other factors, to cause a reverse movement in the opposite direction, until the same forces as before again reverse the direction'. According to the Keynesian conception, then, stability in an unregulated economy occurs only by chance. Having occurred, it will not persist. For the very forces which have led to stability will in time render the system unstable.

The inevitability of transition from one phase to another implies that in the Keynesian model the economy is subject to continuous change (though this, as noted, is not to deny the possibility of a prolonged semi-slump). What Keynes found most unsatisfactory about his *Treatise on Money* was that it 'failed to deal thoroughly with the effects of changes in the level of output'. The *General Theory* sought to rectify this fault. Changes in the level of output and employment and the forces inducing these changes, it was announced in the preface, were to be the book's main concern.

The argument advanced in the *General Theory* was, in brief, that the

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68 Ibid., p. 254.

69 That Keynes's perspective was cyclical has been stressed by Minsky. See Hyman P. Minsky, *John Maynard Keynes*, (Macmillan, London, 1976), especially Chs. 1 and 3, which discuss how in the Keynesian model forces inherent in the system lead to economic instability.


71 Keynes, *General Theory*, p. xxii; emphasis in the original.
volume of employment and output (the dependent variables) were determined primarily by the propensity to consume, the marginal efficiency of capital and the rate of interest (the independent variables). All of the independent variables were 'liable to change without much warning, and sometimes substantially'. Investment was particularly susceptible to change. As early as 1931 Keynes had drawn attention to the fact that investment was capable of 'sudden and violent change' and that such change was of prime importance in understanding the present situation. He suggested in 1937 that his theory could be summed up as follows: 'given the psychology of the public, the level of output and employment as a whole depends on the amount of investment'. But emphasis was placed not just on the level of investment but on its variability. For he continued: 'I put it in this way, not because this is the only factor on which aggregate output depends, but because it is usual in a complex system to regard as the causa causans that factor which is most prone to sudden and wide fluctuation.'

In explaining why fluctuations in investment (or any of the other components of aggregate demand) could have wide-reaching effects, Keynes relied on the multiplier principle. In the General Theory it was argued that an important condition of stability was that the investment multiplier be 'greater than unity but not very large'. For if the multiplier was

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72 Ibid., p. 249.
73 Keynes, 'An Economic Analysis of Unemployment', pp. 354-5.
75 Keynes, General Theory, p. 250.
considerably greater than unity then 'an increase of investment, however small, would set moving a cumulative increase of effective demand until no one at all was employed'.\textsuperscript{76} Given that aggregate employment was normally in an 'intermediate position' between zero and full employment, the implication was that the multiplier was not normally 'enormously large'.\textsuperscript{77} But what is interesting about the multiplier principle is that it embodied the notion of cumulative change. In the Keynesian model not only is there continuous change but the changes occurring have cumulative effects.

To summarise the discussion thus far: according to Keynes the key relationship in the economic system was that between aggregate demand and total output and employment. The key element in aggregate demand was the level of investment. Investment was considered prone to sudden and abrupt changes. Because of cumulative, multiplier processes, the effects of such change could be substantial, instability could be magnified. To Keynes, the nature of the investment was symptomatic of the nature of the system as a whole. He viewed the unregulated capitalist economy as being essentially volatile, as being subject to continuous fluctuations. There was unceasing change in the system, recurrent mutation from one stage to another. Instability was inherent. The very forces producing one phase led eventually to its replacement by another. The economy was characterised by a succession of phases which conformed to a cyclical pattern.

Thus, there was in Keynes's model none of the orderliness which

\textsuperscript{76} \textit{Ibid.}, pp. 251-2.
\textsuperscript{77} \textit{Ibid.}, p. 252.
characterised the neoclassical vision. He denied the idea of an economic cosmos in which the atomistic components, propelled by self-interest and acting in response to price signals, moved the system spontaneously, harmoniously and inherently toward a social optimum in terms of output and employment. Consistent with this, he rejected the argument that the country's economic problems were primarily the result of inflexibilities which were hampering the efficient functioning of the system. In relation to wage flexibility, for instance, he declared: 'There is no ... ground for the belief that a flexible wage policy is capable of maintaining a state of continuous full employment; any more than for the belief that an open-market monetary policy is capable, unaided, of achieving this result. The economic system cannot be made self-adjusting along these lines.'

Keynes denied also the possibility of steady growth. In a letter to R.F. Harrod in 1937 he argued that 'steady growth can only occur as the result of a miracle or intense design.... The maintenance of steady growth is at all times an inherent improbability in conditions of laissez-faire.' In brief, to Keynes the economy was not characterised by an inherent tendency toward equilibrium, by steadiness and stability. Instead, it was flawed, unsteady and unstable.

In explaining the volatility of the system, as noted earlier, Keynes emphasised the important role played by fluctuations in investment. In explaining why investment was prone to sudden change he drew attention to the fact that: 'A monetary economy ... is essentially

78 Ibid., p. 267.
one in which changing views about the future are capable of influencing the quantity of employment and not merely its direction.  

80 The root cause of the economy's volatility lay in the capriciousness of community, and especially business, attitudes. The latter, in turn, resulted from the fact that the future was always uncertain.

As early as 1926 Keynes was discussing the effect of uncertainty in leading to unemployment.  

81 In the General Theory the effects of an uncertain future were stressed. The argument was put forward that the static state analysis of neoclassical theory in which the future does not influence the present broke 'the theoretical link between to-day and tomorrow' and thereby resulted in 'a large element of unreality'.  

82 Economists had not paid sufficient attention to the state of business confidence and its influence on the marginal efficiency of capital (the investment demand schedule). Keynes observed: 'Our knowledge of the factors which will govern the yield of an investment some years hence is usually very slight and negligible.'  

83 Such knowledge was notable for its 'extreme precariousness'. Economic instability could arise from the human

80 Keynes, General Theory, p. xxii.

81 In 'The End of Laissez-Faire' (1926), Keynes declared: 'Many of the greatest economic evils of our time are the fruits of risk, uncertainty, and ignorance. It is because particular individuals, fortunate in situation or in abilities, are able to take advantage of uncertainty and ignorance, and also because for the same reason is often a lottery, that great inequalities of wealth come about' and these same factors are also the cause of the unemployment of labour, or the disappointment of reasonable business expectations, and of the impairment of efficiency and production.' Reprinted in Collected Writings, Vol. 9, p. 291.

82 Keynes, General Theory, pp. 145, 146.

83 Ibid., p. 149.
characteristic that positive action depended largely on 'spontaneous optimism rather than on a mathematical expectation'.

Keynes described the 'spontaneous urge to action rather than inaction' as 'animal spirits'. It was animal spirits rather than 'the outcome of a weighted average of quantitative benefits multiplied by quantitative probabilities' which propelled man into action. It was animal spirits which made 'the wheels go round'. Thus, 'if the animal spirits are dimmed and the spontaneous optimism falters, leaving us to depend on nothing but a mathematical expectation, enterprise will fade and die; - though fears of loss may have a basis no more reasonable than hopes of profit had before.'

This, however, was not to suggest that 'everything depends on waves of irrational psychology': 'We are merely reminding ourselves that human decisions affecting the future, whether personal or political or economic, cannot depend on strict mathematical expectation, since the basis for making such calculations does not exist.' In the face of the fact of an incalculable future, decision-making involved 'choosing between the alternatives as best we are able, calculating where we can, but often falling back for our motive on whim or sentiment or chance'. People fell back also on what was referred to as a 'convention' whereby the unrealistic

84 Ibid., p. 161.
85 Ibid.
86 Ibid., p. 163.
87 Ibid., p. 162.
88 Ibid., pp. 162-3.
89 Ibid., p. 163.
assumption was made that the present state of affairs would continue into
the future. The use of such a convention could ensure stability only if
the conventional could be maintained. However, it was highly unlikely that
the conventional calculation would persist very long: 'A conventional
valuation which is established as the outcome of the mass psychology of a
large number of ignorant individuals is liable to change violently as the
result of a sudden fluctuation of opinion due to factors which do not
really make much difference to the prospective yield; since there will be
no strong roots of conviction to hold it steady.' 90 Thus, at all times it
was possible that the rules and conventions governing economic behaviour
could break down and that the 'thin and precarious crust' supporting the
economy could crack. 91 There was no inherent protective mechanism akin to
the physiological phenomenon of homeostasis. The weakness in the system
was fundamental. Once the crack appeared it was just as likely to open
wider rather than be repaired by natural forces.

In his writings immediately following the publication of the
General Theory, Keynes emphasised that the recognition of the unsettling
effects of an uncertain future was a key difference between his theory and
that of the neoclassical orthodoxy. For example, in an article published
in 1937 (based on a lecture given at Stockholm University in the autumn of
1936), he pointed out that the rate of interest and the marginal efficiency
of capital, those phenomena which particularly interested him and which
figured prominently in his theory, 'are particularly concerned with the
indefinite character of actual expectations; they sum up the effects on

90 Ibid., p. 154.
91 The phrase appears in Keynes, 'My Early Beliefs', p. 447.
men's market decisions of all sorts of vague doubts and fluctuating states of confidence and courage. They belong, that is to say, to a stage of our theory when we are no longer assuming a definite and calculable future. By contrast, the neoclassical orthodoxy was 'concerned with a simplified world where there is always full employment, and where doubt and fluctuations of confidence are ruled out'. As such, the orthodox theory was 'inapplicable to any of the day-to-day problems of ordinary life'. It was really only applicable to a stationary state.

In an address to the Eugenics Society in February 1937, Keynes again took up the issue of an uncertain future and the use of conventions. He began by pointing out that the future never resembles the past and that what the future holds cannot be known. He declared: 'Peace and comfort of mind require that we should hide from ourselves how little we foresee.' This was the basis of the use of conventional judgements or hypotheses about future possibilities. He denounced the 'extraordinary contraption of the Benthamite School' in which the consequences of various forms of actions were assumed to be capable of quantitative expression and as such were supposed to provide the basis for determining appropriate action. He commented: 'No one has ever acted on this theory.' Such a 'contraption', he concluded, exemplified 'the complacency of the nineteenth century ... in their philosophical reflections on human behaviour'.

92 Keynes, 'The Theory of the Rate of Interest', pp. 106-7; emphasis in the original.

93 Ibid., p. 107.

94 Ibid., p. 106.

Also in February 1937, Keynes's article, 'The General Theory of Employment', appeared in the Quarterly Journal of Economics. Written in response to various criticisms of his book, particularly those made by Jacob Viner, the article attempted to summarise the fundamental differences between Keynes's approach and that of the orthodoxy. Of primary importance was the question of a calculable future. The analyses of writers such as Ricardo, Marshall, Edgeworth and Pigou, he conceded, did not rule out change or even the possibility of expectations being disappointed.

But at any given time facts and expectations were assumed to be given in a definite and calculable form; and risks, of which, though admitted, not much notice was taken, were supposed to be capable of an exact actuarial computation. The calculation of probability, though mention of it was kept in the background, was supposed to be capable of reducing uncertainty to the same calculable status as that of certainty itself.\textsuperscript{96}

Such as assumption was erroneous: people in fact had 'only the vaguest idea' of the consequences of their actions.

He agreed, however, that people acted as if they were rational economic men. In doing so, a variety of techniques were used. People assumed that the future would resemble the past. They assumed also, in the absence of evidence to the contrary, that the existing state of opinion was reliable and accurate. Furthermore, they depended not on an individual assessment of future possibilities but on majority opinion which seemingly appeared better informed. Decision-making was essentially an exercise in conformity, in conventionality: 'The psychology of a society of individuals each of whom is endeavouring to copy the others leads to what we may strictly term a conventional judgement.'\textsuperscript{97}

People, as such, were


\textsuperscript{97} Ibid., p. 114; emphasis in the original.
only superficially rational economic men.

The 'flimsy' foundation of the conventional judgment, Keynes maintained, was prone to 'sudden and violent' change:

The practice of calmness and immobility, of certainty and security, suddenly breaks down. New fears and hopes will, without warning, take charge of human conduct. The forces of disillusion may suddenly impose a new conventional basis for valuation. All these pretty, polite techniques, made for a well-panelled board room and a nicely regulated market, are liable to collapse. At all times the vague panic fears and equally vague and unreasoned hopes are not really lulled, and lie but a little way below the surface. 98

From this discussion of the effects of an uncertain future and the use of conventional judgements, and particularly from the passage immediately above, it can be seen that in the Keynesian model there was a close connection between community psychology and the state of the economy. The former was the driving force in the system. Keynes, as noted, emphasised the volatility of investment in causing fluctuations in output and employment. But the instability of investment reflected the instability of conventional judgments concerning the future. Via the level of investment there was a link between expectations and economic performance. Thus, just as knowledge of the future was 'fluctuating, vague and uncertain', 99 so too was the economy. Just as the conventional valuation could break down and collapse so too could the economy plunge into a slump. Clearly, Keynes's image of society and of man underpinned his vision of the economy.

99 Ibid., p. 113.

106.
Something else which emerges is that Keynes's belief in cumulative change encompassed not just the somewhat mechanical multiplier principle but also (given that people's attitudes affect, and are affected by, other people's attitudes) the societal process whereby opinions feed on each other and cause a snowball situation. Because people tend to emulate others a spirit of optimism or pessimism can grow and gather force: 'Once doubt begins it spreads rapidly.'\textsuperscript{100}

Keynes's belief that each individual relied upon conventional judgements, varied his opinion as the majority's opinion varied, acted according to the dictates of the well-informed majority, was at odds with the image of man presented by the neoclassicists. In the neoclassical model, by contrast, decision-making is an atomistic exercise performed individually and independently; the decision-maker is an autonomous entity. Keynes's arguments pointed in the opposite direction: decision-making cannot occur without either conscious or unconscious consideration of the opinions of others.

Keynes rejected also that part of the neoclassicist's philosophy of human nature which saw man as a deliberating, calculating, differentiating, ordering, maximising creature. Keynes's attitude was revealed clearly in a letter to Hugh Townshend in 1938 where he declared:

> Generally speaking, in making a decision we have before us a large number of alternatives, none of which is demonstrably more 'rational' than the others, in the sense that we can arrange in order of merit the sum aggregate of the benefits obtainable from the complete consequences of each. To avoid being in the position of Buridan's ass, we fall back, therefore, and necessarily do so, on motives of another kind, which are not 'rational' in the sense of being concerned with

\textsuperscript{100} Keynes, \textit{General Theory}, p. 317.
the evaluation of consequences, but are decided by habit, instinct, preference, desire, will, etc. All this is just as true of the non-economic as of the economic man. 101

Contrary to the neoclassical model, Keynes believed that decision-making was not primarily an evaluative process involving a conscious choice between alternative consequences. He denied that which was at the core of neoclassical utility theory (whether it be cardinal or ordinal): that individual economic agents can rank their preferences. By implication, he denied also the assumption that the economic agent is consistent in his ordering of choice-objects. His argument was that decision-making was an 'irrational' process (irrational, that is, from a neoclassical perspective) influenced heavily by unconscious motives. This was consistent with the argument in the General Theory, noted earlier, that whim, sentiment and chance figure prominently in decision-making.

Also of interest in Keynes's comments to Townshend was the rejection of the Marshallian belief that decision-making in the economic sphere was qualitatively different from that in the non-economic sphere. To Keynes, there was nothing more rational about economic, rather than non-economic, decisions.

In his 1938 address, 'My Early Beliefs', Keynes claimed that he and the rest of the Bloomsbury group were among the first of their generation to renounce the Benthamite calculus. 102 But he confessed that as a young man he adhered firmly to the belief that people were rational in the sense


102 Keynes, 'My Early Beliefs', pp. 445, 447.
that they were reasonable, malleable and perfectable:

We were among the last of the Utopians, or meliorists as they are sometimes called, who believe in a continuing moral progress by virtue of which the human race already consists of reliable, rational, decent people, influenced by truth and objective standards, who can be safely released from the outward restraints of convention and traditional standards and inflexible rules of conduct, and left, from now onwards, to their own sensible devices, pure motives and reliable institutions of the good.... In short, we repudiated all versions of original sin, of there being insane and irrational springs of wickedness in most men.103

Reflecting on this, he concluded that 'we completely misunderstood human nature, including our own. The rationality which we attributed to it led to a superficiality, not only of judgement, but also of feeling.' These early beliefs were 'pre-Freudian'.104

Keynes's faith in rationality began to break down with the approach of World War I. By 1926 he was denying that 'self-interest generally is enlightened; more often individuals acting separately to promote their own ends are too ignorant or too weak to even these. Experience does not show that individuals, when they make up a social unit, are always less clear-sighted than when they act separately'.105 His verdict in 1938 was that: 'The attribution of a rationality to human nature, instead of enriching it, now seems to me to have impoverished it. It ignored certain powerful and valuable springs of feeling.'106 In particular, it ignored 'the spontaneous, irrational outbursts of human nature ... volcanic and even

103 Ibid., p. 447.
104 Ibid., p. 448.
105 Keynes, 'The End of Laissez-Faire', p. 288; emphasis in the original.
106 Keynes, 'My Early Beliefs', p. 448.
wicked impulses'. A recognition of the strength of unconscious, irrational, non-calculative, non-evaluative forces was evident, as noted, in the analysis in the General Theory and in Keynes's subsequent writings. It was consistent with, in fact underpinned, his denial of the claim that the economic system was self-adjusting. Just as he gradually came to accept that a variety of forces, not all of which were rational, underlay human action, so too did his belief in inherent correcting tendencies begin to crumble. His rejection of this particular neoclassical premise was not just a product of prolonged slump.

Keynes denied also the tenet of neoclassical economics which claimed that individual and societal objectives were generally compatible, that the pursuit of individual maximisation would tend to produce a social optimum. He could not accept such a harmonious vision. He proclaimed in 1926: 'The world is not so governed from above that private and social interests always coincide. It is not so managed here below that in practice they coincide. It is not a correct deduction from the principles of economics that enlightened self-interest always operates in the public interest.' This conviction underlay much of his writings. It was manifested, for instance, in his comments on the paradox of thrift. His argument was that, in a given situation (in this case a slump), that which may seem to the individual to be rational action (to attempt to increase the level of personal savings so as to safeguard against the likelihood of

107 Ibid., pp. 448-9.

108 Keynes, 'The End of Laissez-Faire', pp. 287-8; emphasis in the original.
the continuation of the continuation of depressed conditions) may have deleterious aggregative (societal) consequences (by lowering effective demand). The same conclusion was reached in an analysis of economic behaviour in the opposite conditions - those of excess demand. In *How to Pay for the War* (1940) Keynes insisted that for a fixed economic cake, an attempt by each individual to increase his consumption by spending more would only be at the expense of others and would result ultimately in inflation. 'Thus, what is to the advantage of each of us regarded as a solitary individual is to the advantage of each of us regarded as members of a community.'

Keynes's views on methodology reflected his image of man and vision of the economy. He looked askance at attempts to turn economics into a 'pseudo-natural science'. Disagreeing with Robbins, he argued that economics was a moral science dealing with introspection and value judgements. It dealt also with 'motives, expectations, psychological uncertainties'. He stressed that economists had to be wary of treating the material under analysis as if it were homogenous and constant. 'It

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109 Keynes, *How to Pay for the War*, p. 375.
is as though the fall of the apple to the ground depended on the apple’s motives, on whether it is worthwhile falling to the ground, and on the mistaken calculations on the part of the apple as to how far it was from the centre of the earth.’\textsuperscript{114} This was a warning not just against treating every apple (or economic agent) as being the same but against the reification of data and the over-use of a physical-objects theory to describe economic behaviour. He was criticising the neoclassical argument that it was either unnecessary or inappropriate to inquire into why people act, that it was sufficient to note that they do. Keynes believed that one had to be concerned with motives and imperfections in judgement. One had to search for reasons for actions, not be content merely with describing them.

Contrary to the ideals of neoclassicists such as Walras and Jevons, Keynes was convinced that: ‘The pseudo-analogy with the physical sciences leads directly counter to the habits of mind which is most important for an economist proper to acquire.’\textsuperscript{115} Economists should not be looking for universal laws, once and for all equations and formulas.\textsuperscript{116} Economists had to think in terms of models appropriate to the problem being studied. Given the continual change which characterised the economic system, models would need constant revision. There was no single model endowed with a timeless relevance capable of being applied, with a few modifications, to the analysis of all economics problems. Progress in economics did not

\textsuperscript{114} Ibid., p. 300.
\textsuperscript{115} Keynes to R.F. Harrod, 16 July 1938, p. 300. See also Keynes to R.F. Harrod, 4 July 1938, p. 296.
\textsuperscript{116} Ibid., p. 299.

112.
involve improving an existing model but choosing one relevant to the problem under consideration.

These methodological ruminations reflect an underlying unity in Keynes's outlook. His descriptions of the working of the economy, his arguments concerning the independent variables in his system, his reflections on human nature, his belief in the need for constant revision of models, and his warnings about mathematical and natural science techniques, have in common an emphasis on change, on mutation, on progression, on heterogeneity. What was uppermost in Keynes's mind was the constant state of flux of reality. This was not to say that he believed that one was unable to make generalisations or discern law-like relationships. His writings were full of generalisations and laws (such as the 'fundamental psychological law' relating to income changes and the rate of consumption expenditure). His point, however, was that such statements should not be regarded as applicable at all times and in all places. The unceasing change in human outlooks, aspirations, and personalities, in the social structure, in the type of, and relations between, the factors of production, in the problems facing the economy, and so on, made the search for eternal truths a largely fruitless and unproductive, and ultimately stultifying, exercise.

It was perhaps paradoxical that the General Theory attempted to prove, at least theoretically, the existence of equilibrium levels for output and employment. In other words, the General Theory was concerned with rest states, albeit underemployment rest states. But Keynes's model ('model' is used here in the conventional economics sense) was essentially
a causal model rather than an equilibrium model. He sought to show that changes in output and employment result from changes in effective demand. His model was set in actual, historical, calendar time. It took cognisance of the fact that expectations of the future can alter effective demand. In the Keynesian model the economy moves from an unchangeable past toward an uncertain future. The establishment of equilibrium along this one-way path was, to use his phrase, 'a spurious equilibrium', a fleeting, transient, strictly short-term achievement, precariously supported by expectations which were liable always to change. It was nothing more than a breathing-space.

Keynes's contribution was to show that it was not changing expectations as such which caused economic fluctuations (the notion of alternating waves of over-optimism and over-pessimism in producing business cycles had been a well-established tenet of cyclical analysis prior to


118 This has long been stressed by Joan Robinson. For her most recent pronouncements on the topic, see 'What Has Become of the Keynesian Revolution' (1972) and 'History versus Equilibrium' (1974). Both are reprinted in Robinson, Collected Economic Papers, Vol. 5. See also Joan Robinson, 'Time in Economic Theory', Kyklos, Vol. 33, No. 2, 1980.

119 Keynes, 'An Economic Analysis of Unemployment', p. 356.

120 Shackle, referring to Keynes's use of 'equilibrium', has argued: 'It must be understood as the ephemeral adjustment that may from time to time come about when, by accident or the felicity of chance, affairs are given a breathing-space and something resembling the Marshallian "normal" can come about.' G.L.S. Shackle, Keynesian Kaleidos: The Evolution of a General Political Economy, (Edinburgh University Press, Edinburgh, 1974), p. 46.
1936), but that changing expectations operated via effective demand to produce changes in the level of output and employment. He considered the principle of effective demand to be the most important aspect of his theory - the bulk of the General Theory was concerned with examining its determinants.

In the Keynesian model a given level of expectations is associated with a particular equilibrium level of long-period employment. But before these long-period effects can be worked out the economic system is subjected to a new set of expectations. Thus the economy's equilibrium point is constantly changing. The economy is forever adjusting to new and unattainable equilibrium points. Full employment is but one of the possible equilibria. As such, the economy cannot be described as self-adjusting - there is no inherent tendency toward full employment. Instead, the system is prone to instability. The system's movements through time conform to a cyclical pattern. These cycles result from the level of effective demand (particularly the level of investment demand) moving up and down. Changes in the level of effective demand are primarily related, in turn, to fluctuations in expectations. Fluctuations in expectations

121 To use the terminology employed by Kregel in his illuminating discussion of Keynes's modelling methods, this is Keynes's shifting equilibrium model. Kregel delineates two other models in Keynes's thought: a stationary equilibrium model (long-period expectations are constant, short-period expectations can be disappointed, and the two sets of expectations are independent) and a static equilibrium model (long-period expectations are constant at a given level, short-period expectations are always fulfilled, and both sets of expectations are independent). Both of these were pedagogical devices, used to demonstrate the importance of effective demand and to show that equilibrium could be established at a level anywhere from zero to full employment. The shifting equilibrium model represented what Keynes took to be the real world. See Kregel, 'Economic Methodology'. See also Paul Davidson, Money and the Real World, 2nd Ed., (Macmillan, London, 1978), pp. 372-9.
reflect the fact that the future cannot be reduced to the same calculable status as the present and the past and the fact that economic agents, beset with uncertainty, rely on the opinions and actions of others and base their decisions mainly on such 'irrational' motives as habit, instinct, whim, and sentiment. In short, the Keynesian model is dominated by the notions of change, instability and indeterminancy.

It is now becoming increasingly in vogue to summarise the difference between Keynes and the neoclassicists in terms of Keynes being preoccupied with disequilibrium states and neoclassicists being preoccupied with equilibrium states. This is a potentially misleading characterisation. It is misleading, for instance, if it is taken to mean that Keynes was merely arguing that the existence of rigidities prevented the establishment of the neoclassicist's Utopia. For once Keynesian economics becomes the economics of rigidities and inflexibilities, it becomes a subset of neoclassical economics, a special case in the more general neoclassical theory. This points to the main weakness of such a characterisation: it defines Keynes in terms of neoclassicism. In doing so, it ignores points discussed earlier; it ignores the fundamentally different conceptions of economic life and different interpretations of the notion of equilibrium held by Keynes and the neoclassicists.122

Thus Victoria Chick argues that the proposition, that the General Theory is the economics of disequilibrium, 'lends modern support to the classical view that unemployment is really only transitory - largely frictional - thus paving the way for Phelps et. al. to argue that if only labour were to be fully informed about the true situation, they would, in periods of unemployment, quickly accept a lower wage rather than continuing a fruitless search for employment at the going wage.' Victoria Chick, 'The Nature of the Keynesian Revolution: A Reassessment', Australian Economic Papers, Vol. 17, June 1978, p. 2.

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Although the Keynesian model rejects the optimistic and harmonious vision of the neoclassicists which postulates that imbalances between demand and supply would tend to work themselves out and that resources would tend to be efficiently allocated, the Keynesian alternative cannot be described as pessimistic. It, too, is essentially an optimistic model, although for different reasons. Optimism was manifested in Keynes's belief that the economic problem (poverty in the midst of plenty) would eventually disappear - possibly within a hundred years. It was manifested also in his hope, as he delightfully put it, that: 'The love of money as a possession - as distinguished from the love of money as a means to the enjoyments and realities of life - will be recognised for what it is, a somewhat disgusting morbidity, one of those semi-criminal, semi-pathological propensities which one hands over with a shudder to the specialists in mental disease.' As this passage suggests, Keynes dreamt of an 'Age of Abundance' in which, free from insecurity, people could pursue cultural and intellectual interests and denounce money-grubbing activities.

But the clearest manifestation of Keynes's optimism was his belief in the notion of economic control. As he explained in 1931: 'I believe that our destiny is in our own hands and that we can emerge from [the slump] if only we choose - or rather if those choose who are in authority in the world'.

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124 Keynes, 'An Economic Analysis of Unemployment', p. 344. In his obituary in the Economic Journal, Keynes was referred to as 'the thinker who more than any other has made man master of his fate'. R.F. Harrod and E.A.G. Robinson, 'John Maynard Keynes', Economic Journal, Vol. 56, June 1946, p. 171. Similarly, referring to Keynes's achievements, The Economist declared: 'Never again will it be possible for the State to regard the course of prices, the level of
absence of deliberate management', unless corrective measures are taken', "without purposive direction", ran throughout his writings. Harrod has observed that:

[Keynes] believed that, by care and pains, all our social evils, distressed areas, unemployment and the rest, could be abolished. He believed in planning and contriving. A way could be found. That was his experience in his private life and in the affairs of his college, and the same maxim should be applied in public affairs. He always had a scheme. His mental energy and resources were limitless. If a thing could not be done in this way, it could be done in that.

Thus, despite his gradual recognition of 'irrational' springs of action, Keynes retained his early meliorist position. But his optimism was founded not on a faith in beneficent natural tendencies but on a belief that economic problems could be alleviated by conscious, deliberate, purposive action taken by those in 'authority'. The system could not be

124 (cont.) the national income or the volume of employment as things outside its control. 'John Maynard Keynes', The Economist, 27 April 1946, p. 658.


127 Keynes, 'Poverty in Plenty', p. 491.

128 Harrod, Keynes, p. 192.

129 Indeed in 'My Early Beliefs' Keynes confessed: 'I still suffer incurably from attributing an unreal rationality to other people's feelings and behaviour (and doubtless to my own, too). There is one small but extraordinarily silly manifestation of this absurd idea of what is "normal", namely the impulse to protest - to write a letter to The Times, call a meeting in the Guildhall, subscribe to some fund when my presuppositions as to what is "normal" are not fulfilled. I behave as if there really existed some authority or standard to which I can successfully appeal if I shout loud enough - perhaps it is some hereditary vestige of a belief in the efficacy of prayer (p. 448)'; emphasis in the original.
left alone. It required constant supervision, moulding, direction.

Underlying the belief in economic control were (to use Harrod's phrase) 'the presuppositions of Harvey Road': in particular, 'the idea that the government of Britain was and would continue to be in the hands of an intellectual aristocracy using the methods of persuasion'.¹³⁰ The assumption was that economic management would be the responsibility of an enlightened, public-spirited, wise and intelligent elite or technocracy who, by patience, perseverance, argument and exhortation, would successfully steer the economy. It was these people who had their hands on the economic rudder. It was not assumed that the technocracy was infallible but that it was flexible, able to adapt to different circumstances, problems and demands, willing to experiment and to learn from mistakes.¹³¹

Given that the economy was characterised by perpetual change, it was essential that intervention be discretionary. The idea of pre-set, inflexible, rule-following intervention was alien to Keynes. In his Tract on Monetary Reform (1923) he voiced his disapproval of using 'a precise,

¹³⁰ Harrod, Keynes, pp. 192-3.
¹³¹ As Keynes (and Henderson) wrote in Can Lloyd George Do It?: 'There is no reason why we should not feel ourselves free to be bold, to be open, to experiment, to take action, to try the possibilities of things.' J.M. Keynes and H.D. Henderson, Can Lloyd George Do It? (1929). Reprinted in Collected Writings, Vol. 9, p. 125. In his 'Open Letter to President Roosevelt', he declared: 'You have made yourself the trustee for those in every country who seek to mend the evils of our condition by reasoned experiment within the framework of the existing social system.... Your are feeling your way by trial and error, and are felt to be, as you should be, entirely uncommitted in your own person to the details of a particular technique.' New York Times, 31 December 1933. Reprinted in Arthur Smithies and J. Keith Butters (eds.), Readings in Fiscal Policy, (George Allen and Unwin, London, 1955), pp. 33, 35.
arithmetical formula' as the criterion for regulating the bank rate, government borrowing and trade advances. He favoured instead the use of 'a general judgement of the situation based on all the available data'. He could not accept Fisher's suggestion of a 'compensated dollar': 'I doubt the wisdom and practicability of a system so cut and dried. If we wait until a price movement is actually afoot before applying remedial measures, we may be too late.' Such a scheme, which involved automatic adjustment according to changes in a price index 'without any play of judgement or discretion', had no appeal to him. Economic control required research and understanding. It involved decisions as to timing and method - both of which necessitated judgement, not the following of rules.

How was control to be achieved? Prior to the publication of the General Theory, Keynes had established a reputation as a firm believer in monetary policy in effecting economic control. But the continuation of the depression undermined Keynes's support of monetary policy. In the final version of the book he announced that he was 'now somewhat sceptical' of the ability of variations in the interest alone to produce an optimal rate of investment. Fluctuations in the marginal efficiency of capital would be 'too great to be offset by any practicable changes in the rate of interest'. Keynes believed that monetary policy by itself was an insufficient weapon with which to exercise economic control and, as

133 Ibid., pp. 147, 148.
134 Ibid., p. 148.
135 Keynes, General Theory, p. 164.
such, the government, and not just the banking authorities, must assume responsibility for control. He believed also that monetary policy was ineffective in raising confidence and in overcoming a deep slump. But he did not believe, as has sometimes been assumed, that monetary policy was of little importance in all situations. In his opinion, the efficacy of monetary policy varied according to the economic climate.  

As noted, given that economic management could not be left solely in the hands of the monetary authorities, Keynes believed that the government would have to take a much more active role in economic affairs: 'The controls necessary to ensure full employment will ... involve a large extension of the traditional functions of government'.  

What would this involve? First, the government would have to attempt to redistribute incomes so as to raise the propensity to consume. Second, as 'the duty of ordering the current volume of investment cannot safely be left in private hands', it was envisaged that 'a somewhat comprehensive socialisation of investment will prove the only means of securing an approximation to full employment'.

Though the meaning of 'a somewhat comprehensive socialisation' is open to a variety of interpretations, it is clear that socialisation was not equated with socialism. For Keynes continued:


137 Keynes, General Theory, p. 379.

138 Ibid., p. 320.

139 Ibid., p. 378.
But beyond this no obvious case is made out for a system of State Socialism which would embrace most of the economic life of the community. It is not the ownership of the instruments of production which it is important for the State to assume. If the State is able to determine the aggregate amount of resources devoted to augmenting the instruments and the basic rate of reward to those who own them, it will have accomplished all that is necessary. 140

It would seem that what Keynes was suggesting was that public sector investment be used to raise aggregate expenditure to a level commensurate with a high rate of employment and that the ratio of public sector to private sector investment increase over time. Such a suggestion was in line with his repeated advocacy of public works expenditure as a means of restoring employment: a number of his most famous pamphlets, such as Can Lloyd George Do It? (1929; co-authored with H.D. Henderson) and The Means to Prosperity (1933), were written in an attempt to convince the government and the public of the efficacy of such expenditure. He was now arguing that public investment expenditure should be used not just as a temporary expedient (which suggested that it could be turned on and off at will), but that the level of public investment should grow continuously (though not necessarily rapidly) so as to provide a stabilising force in the system.

The phrase 'Keynesian Revolution' is now most commonly associated with the abandonment of balanced budget principles and the acceptance of budget deficits or surpluses to regulate the level of economic activity. Keynes is attributed with having transformed the conception of the budget as a mere financial device governed by accounting principles to an effective instrument with which to exercise economic control. Yet the General Theory had nothing explicit to say about budgetary policy. And his

140 Ibid.
writings prior to 1939 cannot be described as being actively concerned with promoting a change in the public's attitude toward the role of the budget.

It was not really until World War II that Keynes formulated in any detail his ideas on budgetary policy and that these ideas gained acceptance. In his 1940 pamphlet, How to Pay for the War (which originally appeared as a series of articles in The Times the previous year), Keynes showed that the principle of effective demand could be used to analyse a situation not just of insufficient aggregate demand but also of excess aggregate demand. Moreover, he demonstrated how budgetary policy constituted a weapon for dealing with what is now known as demand-pull inflation. Keynes provided a new perspective: his argument was in effect that what was at issue was not the balancing of the budget itself but the balancing of the economy as a whole. His contribution was to highlight the role of the budget in effecting a balance between aggregate demand and supply. The Kingsley Wood Budget of 1941 was testimony to Keynes's influence: the Budget marked a radical departure away from the conventional Treasury approach toward the Keynesian economic balance approach. The budget was incorporated into a macroeconomic vision.

Keynes explained in 1940 that he wanted the plan presented in How to Pay for the War to be thought of as a first instalment of a comprehensive social policy to regulate the general rate of spending so as to avoid the disastrous alternations of boom and slump which otherwise will

continue to undermine the foundations of society'. He continued:

I am not proposing an expedient, undesirable for its own sake, just for the purpose of financing the war. I am seizing an opportunity, where the need is obvious and overwhelming, to introduce a principle of policy which may come to be thought of as marking the line of division between the totalitarian and the free economy. For if the community's aggregate rate of spending can be regulated, the way in which personal incomes are spent an the means by which demand is satisfied can be safely left free and individual. 142

These passages provide a useful conclusion to an analysis of Keynes's model in that they capture several fundamental features of the model. The reference to 'disastrous alternations of boom and slump' reflects his belief that the system was prone to instability and moved in cyclical fashion. The references to aggregate spending and the need to regulate it highlights, first, the emphasis he attached to the level of demand; second, his concern with macroeconomic concepts - his approach was essentially an aggregative approach; third, his conviction that the economy could and should be controlled and regulated; and, fourth, it suggests that there is validity in attaching Keynes's name to the fiscal revolution which occurred during and after the war. Finally, the passages show another feature of the model: Keynes believed that the control of aggregate spending levels was in fact a policy of liberation - people no longer need be shackled by fear of insecurity; they could be left to spend their money as they liked; they could exercise 'choice and initiative'.

The Keynesian and Neoclassical Models: The Importance of the Image of Man

The point of departure between the Keynesian and neoclassical models can be traced to their ideas concerning human nature. In the neoclassical model man is driven into action by self-interest. His goal is the maximisation of utility or profits. Man is fundamentally rational in the sense that his actions are premeditated, the result of calculation and deliberation. Given that he is driven by self-interest, it is postulated that in a market economy man has to conform and adapt to the vicissitudes of the market. Thus, the force of competition obviates the possibility of anarchy. All economic agents are ruled by the market. Individual and societal interests are correlated by market forces. Subservience to the market becomes the basis for a view of the world which is characterised by orderliness and regularity. This orderliness and regularity suggest that economic activity can be translated into law-like statements. Such statements can be used, in turn, for predictive purposes. Given that the whole is merely the sum of its parts, the world can be attributed with the rationality which is characteristic of the individual decision-maker.

The Keynesian model acknowledges calculation and deliberation in its image of man but, in contrast to the neoclassical, they are not attributed with being the primary characteristics of human nature either in or out of the economic sphere. Rather, emphasis is given to such 'irrational' and non-calculative springs of action as whim, sentiment, habit, instinct, and so on. Furthermore, man is judged to be fundamentally communal creature relying on the opinions of others. But conventional judgements are notable for their liability to change - it is argued that so long as the future remains uncertain, human expectations will be characterised by volatility. Keynes's image of man becomes the basis for a

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view of the world which is characterised by disorder and irregularity. The system fluctuates, is unstable, has a proclivity toward conditions of semi-slump rather than full employment. There is no mechanism to ensure that individual and societal interests will coincide. The system needs to be, and can be, controlled. The world, in brief, reflects the capriciousness and unpredictability of man's expectations.

There is in Keynes's model an uneasy tension and again it is his philosophy of human nature which is the source of this tension. Although in the General Theory Keynes emphasised the unconscious, irrational aspects of investment behaviour he continued to believe that people were reasonable or, more accurately, that people could be induced to adopt a more reasonable stance via patient and logical counselling. By implication, Keynes believed that human nature was to a degree malleable and hence that people could be induced to overcome some of their 'vague panic fears and doubts' and thereby achieve a more orderly and more stable economy. More importantly, Keynes assumed that it was possible to combine individualism with greater equality. His suggestion that income be redistributed in a more equitable manner and his conviction that there could be an 'Age of Abundance' in which poverty had become a thing of the past, imply that the establishment of a social consensus was believed to be possible. And yet, so he argued, his aim in the General Theory and other writings was not just to preserve individualism, the exercise of individual free choice and initiative, but to enhance it. Keynes's mid-liberal stance was that individualism and greater equality need not be conflicting ideals. On the contrary, he seems to have believed, and it is this belief which was increasingly to be challenged in the post-war period, that individualism could quite successfully be combined with equality. Economic security, he believed, laid the foundations for economic responsibility.
The Post-War Interpretation of the Keynesian Model

Most men wander hither and thither, guided and, at times, hypnotized by more than one model, which they seldom trouble to make consistent, or even fragments of models which themselves form a part of some none too coherent or firm pattern or patterns.

- Isaiah Berlin, 1962

From a theoretical perspective, there has been no Keynesian revolution. Instead, post-war economics has been dominated by a hybrid model known variously as the 'neoclassical synthesis', 'bastard Keynesianism', 'neo-neoclassicism', and 'classical Keynesianism'. This hybrid was made up of elements from both the Keynesian and neoclassical models. However, in the fusion the revolutionary aspects of the Keynesian model - the assumed absence of self-adjusting tendencies, the denial of the rational, calculating, maximising image of man, the concern with historical rather than logical time, and the use of causal rather than equilibrium models - were either ignored, by-passed or misunderstood. And that part of the Keynesian model which was accepted became distorted. In particular, the assumption of economic control became known as fine-tuning and was accorded a degree of efficacy which would have disconcerted Keynes. The comments in the General Theory on monetary policy were often translated incorrectly to mean that money does not matter and that fiscal policies could cure all. Keynes's name became associated also, via the Phillips curve, with the notion of a trade-off between unemployment and inflation - something which he most surely would have disapproved of. The inspirational figure for


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post-war economics was not really Keynes but Walras. The ruling paradigm was a determinate system of general equilibrium, not the indeterminate alternative offered by Keynes.

The Keynesian message began to be defused not long after it appeared. The work of J.R. Hicks was particularly instrumental in this regard. In 1937 Hicks's famous article appeared in Econometrica which, by the use of of the ISLM (or SILL) diagram, purported to summarise the essence of the Keynesian model. The ISLM framework became quickly and widely accepted. If, as Trevithick has suggested, one is to distill the 384 pages of the General Theory into a single diagram, then the ISLM apparatus is perhaps a useful device. Its greatest weakness, however, is that it is based on the assumption that expectations do not change over the length of the curves. In other words, it ignores uncertainty. However, if expectations do change then it is likely, because of the interdependence of the curves, that not just one but both curves will shift and hence the final outcome becomes indeterminate and the diagram's prescriptive value for policy decisions is undermined. As Hicks himself

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144 Rober Clower has gone so far as to claim: 'No living scholar has done more than John Hicks to shape contemporary modes of economic analysis.' Foreword to J.R. Hicks, The Crisis in Keynesian Economics, (Basic Books, New York, 1974), p. vii.


147 Moggridge, Keynes, Appendix: 'A Note on the Standard Presentation of the General Theory'. Moggridge notes: 'One can, however, probably use the formulation reasonably safely if one talks of relatively small changes in the system'. (p. 166; emphasis in the original). Fusfeld argues that as a result of changing expectations, 'Both the IS and LM curves persist in jumping about on the page like the croquet mallets in Alice in Wonderland that kept turning into flamingoes.' Daniel R. Fusfeld, 'The Conceptual Framework of Modern Economics', Journal of Economic Issues, Vol. 14, No. 1, March 1980, p. 13.
has acknowledged recently, the ISLM framework 'reduces the General Theory to equilibrium economics; it is not really in time'.\(^{148}\) He continued: 'That, of course, is why it has done so well.'\(^ {149}\)

Hicks contributed not only to the conversion of Keynes's theory to a form of neoclassical equilibrium economics, but also led the transition away from Marshallian neoclassicism (with its emphasis on partial equilibrium analysis) toward the general equilibrium and mathematical neoclassical economics of Walras. This transition got under way in Britain in the 1930s and Hick's Value and Capital, published in 1938, represented a landmark. Hicks announced in the introduction to his book that economic theory needed a technique for analysing the interrelations between markets. One was thus 'naturally impelled' to turn to the writings of Walras and Pareto and also Wicksell. He continued: 'The method of General Equilibrium, which these writers elaborated, was specially designed to exhibit the economic system as a whole in the form of a complex pattern of interrelations of markets. Our work is bound to be in their tradition, and to be a continuation of theirs.'\(^ {150}\) The success of the transition toward


\(^{149}\) Hicks, 'Some Questions of Time', p. 141. There is of course more to the popularity of the ISLM diagram than this. One would also have to list its simplicity and, linked with this, its usefulness as a didactic device. In addition, it satisfies the manipulative longings of economists: the apparatus can be used to ascertain the effects of varying circumstances and assumptions and policies. It is an ideal 'puzzle' for economists to play with.

Walrasian analysis, instigated by Hicks and led in the post-war period by Arrow, Debreu and Hahn,\textsuperscript{151} was such that by 1962 Samuelson could claim: 'Today there can be little doubt that most of the literary and mathematical economic theory appearing in our professional journals is more an offspring of Walras than of anyone else (and I stress the adjective literary).'\textsuperscript{152}

Another post-war development in economic theory which constituted a rejection of a fundamental element of the Keynesian model was the Pigou effect or, as it later came to be known, the real-balance effect.\textsuperscript{153} The real-balance effect sought to show that the General Theory had failed to prove that the economic system lacked self-adjusting mechanisms. The idea had first been propounded by Haberler in 1939 but was considered in detail by Pigou in 1943 in an article in the Economic Journal. The purpose of the article was 'to show that, in given conditions of technique and so on, if wage earners follow a competitive wage policy, the economic system must


move ultimately to a full employment stationary state; which is the essential thesis of the classicals. There can be no question at all that in this event the equilibrium attained is stable.\textsuperscript{154} The argument advanced, in its simplest form, was that prolonged recession causes wages and prices to fall. As they fall the purchasing power of a given sum of money increases. People, finding that the money they have in the bank now commands a greater amount of goods and services, will be induced to spend more. The rise in spending will be associated with increased output levels which in turn will raise aggregate employment. If the price deflation is great enough then, eventually, full employment will be restored. When Pigou took up the issue again four years later, he conceded that 'the puzzles we have been considering ... are academic exercises, of some slight use perhaps for clarifying thought, but with very little chance of ever being posed on the chequer board of actual life'.\textsuperscript{155} Nevertheless, Pigou was accorded the theoretical victory. The Pigou effect, it was claimed, proved that the system was self-adjusting - at least in theory - and that Keynes therefore was wrong. Keynes's triumph was relegated to the policy sphere. For it was conceded that the Pigou effect was too weak and too slow to be of much practical consequence and that policy initiatives could and should be used to hasten the return to full employment equilibrium.\textsuperscript{156} But with the restoration of the concept of a self-righting


\textsuperscript{155} A.C. Pigou, 'Economic Progress in a Stable Environment', \textit{Economica}, Vol. 14, August 1947, p. 188.

\textsuperscript{156} See, for instance, Don Patinkin, 'Keynesian Economics Rehabilitated: A Rejoinder to Professor Hicks', \textit{Economic Journal}, Vol. 69, September 1959, p. 586.
system (operating slowly perhaps but operating nevertheless) the way was clear for a continuation of determinate equilibrium theorising. Keynes was pushed further into the background.

By restricting Keynes's analysis to the policy sphere, it was an easy step to argue that Keynesianism, thus defined, could be meshed with neoclassicism. Keynes becomes relevant only in so far as it is necessary to hasten natural tendencies toward full employment. And once full employment has been established, neoclassical theorising comes into its own.157 This was the essence of what Samuelson labelled the 'neoclassical synthesis'. The synthesis was unveiled in the 1955 edition of his highly successful text, Economics. The synthesis, as Samuelson defined it,

combines the essentials of the theory of aggregative income determination with the older classical theories of relative prices and of microeconomics. In a well-running system, with monetary and fiscal policies operating to validate the high-employment assumption postulated by the classical theory, the classical theory comes back into its own and the economist feels he can state with renewed conviction the classic truths and principles of social life!158

Given a state of full employment, interest centres on markets, pricing and resource allocation - the main neoclassical concerns. Cyclical fluctuations are recognised but abstracted from. For governments are assumed to have now the knowledge to prevent both inflation and unemployment (then largely independent phenomena). Given continuous full employment, Samuelson explicitly acknowledged, Keynesian economics eventually becomes unimportant: 'if modern [Keynesian income

157 The extent to which Keynes himself was responsible for encouraging such views is discussed in Chapter Ten.

determination] economics does its task well so that unemployment and inflation are substantially banished from democratic societies, then its importance will wither away and the traditional [neoclassical] economics ... will really come into its own - almost for the first time'.

It is interesting in this regard to consider Samuelson's comments on the Pigou effect. His verdict in 1946 was that 'the sum and substance of [Keynes's] heresy' was his denial of the claim that economic equilibrium could occur at less than full employment, that there was an invisible hand correlating the actions of self-interested individuals to produce a social optimum. His view in 1963 was that: 'What is most shocking in a book is not necessarily most important and lasting.' He claimed that Keynes's insights would have been just as valid if he had argued at the beginning of the General Theory that it was reasonable to assume that money wages were sticky downwards. This, in effect, was an argument in favour of the interpretation of Keynesian economics as the economics of rigidities and inflexibilities. The weaknesses in such an interpretation have been noted earlier. Samuelson believed that Pigou had demonstrated 'that within a Keynesian system full employment can in all probability be fully

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restored'. His judgement was that: 'While Pigou, rightly in my opinion, did not consider [the real-balance] mechanism a useful one for policy, it did serve to save face and honor for believers in the harmony of equilibrium. This was a worthy achievement, purchased at little cost. And now the air was cleared to tackle matters of substance and not of ideology.' The last sentence in this passage is interesting. The question of self-adjustment was categorised as merely an ideological question. This, in turn, reflecting the influence of the logical positivism movement of the 1920s and beyond, made the self-adjustment question an undesirable topic of analysis. For that which smacked of ideology robbed economics of its claim to be a pure science.

The neoclassical synthesis was un-Keynesian not only in its abstraction from the instability of the capitalist system but also in its terse dismissal of the difficulties involved in avoiding inflation and unemployment. As Joan Robinson has pointed out:

Keynes did not maintain that everything would be easy once the principles of employment policy were understood, or that simple automatic regulators could be fitted into the system of private enterprise economy that would dispense with the need for wise judgement. The main message of the General Theory was negative. It struck off the shackles of laissez-faire ideology. Keynes knew that new freedom would require fresh solutions. He certainly did not see himself as a quack peddling a panacea.  

During the 1950s and 1960s, however, adherents to the neoclassical synthesis did interpret Keynesian theory as a panacea. Fiscal and monetary

162 Ibid.
163 Ibid., p. 333.
policies (to some adherents, however, monetary policy was not of much consequence), it was believed, could readily be used to maintain high employment at a steady level and to keep inflation reasonably low. This confidence was captured in the mechanistic metaphor of 'fine-tuning' which came into vogue in the 1960s. Underpinning the concept of fine-tuning was the assumption that movements in the economy were capable of precise measurement and prediction. Clearly, such beliefs indicated that Keynes's arguments concerning the fact that knowledge of the future is fluctuating, vague and uncertain had been either ignored or forgotten. Fine-tuning accorded the notion of economic control an aura of certainty and ease which was far removed from Keynes's interpretation of the concept.

By the beginning of the 1960s Keynesianism had been meshed with the supposedly empirical phenomenon known as the Phillips curve. In an article published in Economica in 1958, A.W. Phillips claimed that empirical evidence (Phillips used British data stretching back for nearly a century) revealed a relatively close relationship between changes in money wages and the rate of unemployment. He argued that the rate of change in money wages was greater as unemployment became lower. This relationship between wages and employment levels, plotted in diagrammatic form, became known as the Phillips curve. The curve became the basis of a massive research programme: attempts were made to draw the curve for other countries, to test its validity, to make it more sophisticated. In 1960 Samuelson and Solow modified the Phillips curve so as to show how the percentage change in the American unemployment rate had varied over the

previous twenty-five years in relation to the percentage change in the annual inflation rate. Samuelson and Solow concluded that to avoid inflation, unemployment would have to rise to about 5-6 per cent. A lower unemployment rate would entail inflation. For instance, an unemployment rate of 3 per cent would be associated with an annual inflation rate of 4.5 per cent. The implication of these findings was that there was a trade-off between inflation and unemployment. Samuelson and Solow were offering policy-makers a 'menu of choice': lower unemployment could only be purchased at the cost of higher inflation; policy-makers had to decide upon an appropriate mix.

The fact that Keynesianism became widely associated with the Phillips curve was indicative of the extent to which a marked gulf had developed between what Leijonhufvud has coined the economics of Keynes and Keynesian economics. Weintraub has complained, with justification, that: 'Technically, proponents are apt to overlook Phillips' empirical curve-fittings in an analytical leap toward smooth functions which suppress an immanent range of indeterminateness.' The Phillips curve, with its


167 Axel Leijonhufvud, On Keynesian Economics and the Economics of Keynes: A Study in Monetary Theory, (Oxford University Press, New York, 1968). Interestingly, as Davidson has noted, although Leijonhufvud pointed to a distinction between Keynesian Economics and the Economics of Keynes, he insisted that the latter could and should be interpreted from a Walrasian general equilibrium perspective. Leijonhufvud now considers this interpretation faulty as Keynes was 'a price-theoretical Marshallian'. See Davidson, Money, pp. xii-xv, xvii-xviii and 1n; Axel Leijonhufvud, 'Keynes' Employment Function', History of Political Economy, Vol. 6, 1974, pp. 164-5, 169.

law-like appearance, its guise of universality, its claim to have produced a precise diagnostic chart with which to guide the policy prescriptions of governments, was directly counter to Keynes's views on methodology discussed earlier. Keynes would also have found distasteful and defeatist the notion of a trade-off. Weintraub puts the point well:

Philosophically, Phillips curve addiction perpetrates a cruel hoax on Keynes in its invitation to abide some unemployment and some inflation; it has led some Keynesian to abdicate the promised land of full employment for the comfort of vague but possible price damping. It has led others to brush off inflation as unimportant. Keynes's entire intellectual commitment was to use reason to eradicate economic ailments rather than to 'trade-off' one ill for another malady. 169

In summary, the post-war interpretation of Keynes's model has been largely from within a neoclassical perspective. That which could be accommodated within the neoclassical framework, that which seemed to validate neoclassical theory, has been accepted; the rest has been abstracted from or dismissed as being without foundation. The resulting synthesis bequeathed a view of the world (which persisted until the stagflation of the 1970s) in which policy-makers, aided by ISLM diagrams and Phillips curves, could be complacently confident in their ability to fashion an economic system in which employment remained at high levels, interest centred on the allocation of resources, and the validity of neoclassical theorising became evident. A key difference between the neoclassical synthesis and the neoclassical model, however, was the advocacy of discretionary economic policies by adherents to the synthesis. The Pigou effect was accepted by such adherents but provided little comfort or optimism that full employment equilibrium could readily

169 Ibid., pp. 43-4.
be achieved by 'natural' forces. Hence, discretionary policies were considered essential. 170

Appendix to Chapter Three: Monetarism

Monetarism can conveniently be considered as a subset of the neoclassical model. Monetarism accepts most of the major premises of orthodox neoclassicism, although its emphasis varies on particular topics. As such, the monetarist model is at loggerheads with the Keynesian. Keynes most certainly would have agreed that money matters but he would have scoffed at the suggestion that only money matters. Nor, as noted, would he have accepted the idea of fixed, pre-set rules for monetary growth and the abandonment of discretionary government policy. More fundamentally, Keynes would have been quick to observe and denounce the underlying postulate of monetarism: that the economic system is self adjusting, that full employment is the natural state to which the economy tends. Milton Friedman, the monetarist Messiah, endorses the real balance effect. He argues that the theoretical developments of Haberler and Pigou undermined that which he considers the central Keynesian proposition: the idea of underemployment equilibrium even under flexible wage conditions. 'Henceforth, unemployment had again to be explained by rigidities or imperfections, not as the natural outcome of a fully operative market process.' 171 Friedman's system is a justification of the role of markets,


competition and the pricing process. His ideal is a world characterised by flexibility and mobility, where governments have abdicated discretionary policies, and where the exercise of unrestricted personal initiative and self-interest pushes the system toward full employment equilibrium.\textsuperscript{172} All this is in accord with the neoclassical model.

\textsuperscript{172} The Friedman philosophy is set out clearly in Milton and Rose Friedman, \textit{Free to Choose: A Personal Statement}, (Penguin, Harmondsworth, 1980).
Part Two

Historical Perspective:

The Genesis of Australian Treasury Thought
Introduction to Part Two

The Treasury Surveys of 1956 and beyond were a legacy of a fundamental and far-reaching intellectual shift, labelled here under the generic title of Keynesianism, which became apparent during World War II and whose earliest manifestations can be traced to the 1930s. Part Two attempts to place the analysis of Treasury thought in historical perspective by analysing this intellectual shift, by discussing its origins, implications and pervasiveness and by examining its fate in the first dozen post-war years.

Part Two consists of two chapters. The aim of Chapter Four is to outline the adoption of the Keynesian model in Australia. It argues that the acceptance of Keynesianism was largely complete by 1945. By then the idea of a self-regulating system had been rejected, the notion of control had been accepted (at least in theory), and a new-found optimism in the possibility of continuous progress underpinned community attitudes. Chapter Five examines the evolution of the Keynesian model from 1945 to 1956. It examines the anti-cyclical initiatives (or non-initiatives) of both the Labor and Liberal-Country Party coalition governments and concentrates on the acceptance in practice of using fiscal and monetary policies to regulate the level of economic activity. Against the background provided by Chapters Four and Five, the early Treasury Surveys can be better understood and the extent of the change in Treasury thought from 1956 to 1979 can be more readily appreciated.
Chapter Four: The Adoption of Keynesianism in Australia up to 1945

Perhaps the outstanding feature of economic thought during World War II was the acceptance of the notion of economic control. The aim of this chapter is to outline how and why this notion came to be accepted as essential and achievable. The chapter is not restricted, however, to an analysis of the policy aspects of Keynesianism. It seeks to show that the attention given to economic control reflected a particular view of the economic system and a particular optimism concerning human capabilities and possibilities.

From Impotence to Control

In the past twenty years or so there has been a remarkable change in our attitudes to economic policy. In the calamitous days of the early thirties there were few people who had any confidence in the efficacy of government economic policy, and, indeed, the depth and duration of the depression hardly justified confidence. But today governments have shown themselves willing to adopt policies aimed at maintaining a high level of economic activity. These policies have been fairly effective, but what is more important, people have come to accept the view that conscious governmental action in economic matters is necessary.

- P.H. Karmel, 1954

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The Financial Orthodoxy of the 1930s

The chief indictment of the economic system is not its human control, but the absence of adequate control, and the failure of any power or authority to achieve the reasonable degree of

security we expect. Production stumbles along an uncharted path and unemployment is a spectre dogging its footsteps.

- J.B. Brigden, 1930

The increased power enjoyed by the Treasury during the 1930s was not accompanied by any significant change of vision. Throughout the 1930s the annual budget continued to be seen in terms of a mere financial statement rather than as an instrument of stabilisation. As Crisp has commented in relation to Casey's 1938-39 Budget: 'One gathered that the general level of economic activity had an effect on budget totals but hardly the reverse.' This was a world concerned not with economic aggregates and their interaction but with independent, individual units. Before the Joint Select Committee on Public Accounts in 1932, the Secretary to the Treasury, J.T. Heathershaw, was asked whether he thought the grand totals of the revenue and expenditure of the Consolidated Revenue Fund should be shown in the annual budget papers. He replied: 'I am inclined to question the value of a statement giving the total expenditure, as it appears to me to be almost meaningless.'

Percy Spender has provided a first hand account of the Treasury's approach to budgeting during the 1930s. He refers to the 'somewhat casual way' in which Stuart McFarlane ('Misery Mac'), the Secretary to the


4 Quoted in 'Report from the Joint Select Committee on Public Accounts', *CPP*, 1932-33-34, Vol. 4, p. 43.
Treasury, put the Budget of September 1939 before him (Spender was then Assistant Treasurer):

He presented me with a large foolscap piece of paper - I can see it now - on which he had worked out what I can only call his 'sums'. Our total expenditure for the different departments and services of government etc. would amount to so much. Revenue, at existing rates of taxes, direct and indirect, together with customs and excise, plus miscellaneous items, was estimated to amount to such and such. The difference between estimated expenditure and revenue would need to be bridged by increased taxation, customs and excise - different formulas being suggested for choice - and loans. There would be figures to suggest amounts thought capable of being raised by the latter method. It was for the government to make a choice between how much should be obtained by increased taxation, customs, excise, etc., and how much should be sought by way of loan.

That, in substance, was the outline, and as such, stated the problem and how it might be dealt with in terms of mere money. There was nothing, however, to indicate a financial policy geared to war, or any statement of principle or planning as to how the economy of the nation was to be organised for war. It was, as I saw it, merely a statement on what money was called for by the various departments, and how it might be obtained.5

The budget, as Spender points out, was seen by the Treasury in terms of 'mere money', governed by accounting, balance sheet, principles. Budgeting was simply a matter of estimating expenditure and then determining the ways in which the revenue to cover this expenditure could be raised. Balanced budgets were the inviolable ideal. That the budget could be used to mobilise real resources, that is, to channel and stimulate economic activity, was not envisaged. The Treasury's only concern was with 'sums', in particular with keeping these sums to a minimum.6

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6 S.J. Butlin points out: 'The doctrine of conservation of resources in the sense of money was a firmly held part of Treasury theory before the war when, from its frequent appearance in the statements of a former Treasurer, Mr Casey, it was irreverently known to some academic economists as "Caseyism".' S.J. Butlin, War Economy 1939-1942, (Australian War Memorial, Canberra, 1955), p. 201.
J.A. Lyons, who became Prime Minister in December 1931 and remained so until 1939, agreed with the Treasury approach. Lyons was a disciple of the canons of sound finance and endorsed the principles of the Premiers' Plan. The Lyons Government adopted a fatalistic approach to Australia's economic situation, arguing that all that could be done about the severe unemployment problem, apart from further reducing the costs of production (primarily by means of wage cuts), was simply to wait and pray for an improvement in the prices of Australia's export commodities. Eventually profits would reappear but that day could not be rushed. Lyons's policies generally tended to dampen the course of economic recovery. In line with financial orthodoxy, the budget deficit became progressively smaller and strict control was exercised over the level of current public expenditure. Unemployment relief was paltry and hampered by a rigid adherence to the doctrine that public works spending should be on 'reproductive' items. In his budget speeches Lyons insisted that governments were extremely limited in their ability to provide full-time work for those currently unemployed. It was the private sector, not the public sector which alone would ultimately absorb the bulk of the unemployed. He believed that relief schemes would not permanently ease unemployment, arguing that: 'The work provided would be largely of an unproductive and temporary nature, and at the conclusion of it those who had been so employed would again be relegated to the ranks of the


8 See, for example, the 1933-34 Budget Speech, *CPD*, Vol. 141, 4 October 1933, p. 3209.
unemployed. 9

b) The Full Employment White Paper

The attitude that governments were essentially impotent in their ability to
deal with the problem of unemployment was to break down by the end of World
War II. The outstanding symbol of the change in attitude occasioned by the
war was the 1945 White Paper, Full Employment in Australia. 10 The Paper
opened with the declaration that the government considered full employment
a 'fundamental aim'. Unemployment was branded an evil. The provision of
'the general framework of a full employment economy, within which the
operation of individuals and businesses could be carried on' was deemed a
responsibility and an obligation of Commonwealth and State governments.
This would involve, in very broad terms, the maintenance of expenditure on
goods and services at a level commensurate with the preservation of full
employment.

In introducing the Paper to Parliament, J.J. Dedman argued that
unemployment, by averaging more than 10 per cent for the twenty years from
1919 to 1939 (and peaking at more than 25 per cent in the worst years), was

9 Prime Ministerial broadcast, 8 November 1933. Quoted in W.R.
MacLaurin, Economic Planning in Australia 1929-36, (P.S. King and Son,

10 Full Employment in Australia, (Commonwealth Government Printer,
Canberra, 1945). For a painstaking but somewhat directionless account
of the making of the White Paper, see Selwyn Cornish, 'Full Employment
in Australia: The Genesis of a White Paper'. Paper presented to the
Post-War Reconstruction Seminar, Canberra, August-September 1981. For
a briefer account, see S.J. Butlin and C.B. Schedvin, War Economy
1942-1945, (Australian War Memorial, Canberra, 1977), pp. 673-79. See
also, W.J. Waters, 'Australian Labor's Full Employment Objective,
now considered a defining characteristic of capitalism. Given such a characteristic, the Labor Government's full employment policy was a 'positive contribution to the security of the individual'. The Paper, Dedman insisted, constituted 'a charter for a new social order'.

The White Paper involved a fundamental break with the past. It involved looking at the economy differently. Output levels, rather than cost and price levels, were now the major source of attention. Linked with this, the importance or effective demand was recognised and emphasised. The attention given to output levels turned the government's attention to the economy as a whole and seeing, at an aggregative level, its interrelatedness. That the budget affected, and was affected by, the rest of the economy was now appreciated. More importantly, the government was proposing intervention in the economy whereas previously it had been considered unwise and improper. Expenditure levels were to be regulated by offsetting variations in public capital expenditure so as to maintain balance in total expenditure. And as a result, fluctuations in the economy were to be controlled, the instability to which the economy seemed inevitably prone was to be excised, and employment was to be maintained at continuously high levels. Such views represent the most remarkable aspect of the Government's break with the past. Underlying the aim of full employment was the belief that the economy could and should be manipulated to achieve particular desired ends. The significance of this cannot be overstated. Fatalism, the idea of subservience to the unregulated workings of the market economy, had been jettisoned. Even fluctuations caused by changes in export prices, previously accepted with resignation, were now

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thought to be capable of some sort of control. Control is the key. It is
the chief distinguishing characteristic of the change in economic
thought. There was broad agreement among both government and opposition
parties that some measure of central control was not only possible but
necessary. Control would be the saviour of the Australian capitalist
system. It would be the exorcist of the insecurity caused by the
depression.

Explaining the Acceptance of Control

In explaining why the Keynesian notion of control came to be accepted by
the end of World War II, it is possible to suggest a variety of causal
factors. The discussion below considers three broad factors which seem
particularly important.

It is necessary first, however, to put the notion of control in
perspective. In Australia the pre-Keynesian conception of the role of
government in economic affairs was far removed from one of strict laissez-
faire. In fact Australian history has been characterised throughout by a
dependence on governments and by a high level of government regulation.
However, the horizon of pre-Keynesian, pre-World War II, regulation was
essentially piecemeal rather than integrated, microeconomic rather than
macroeconomic. Regulation was exercised by a plethora of competing
institutions including the Federal government, the states, the Tariff
Board, the Commonwealth Bank, the Commonwealth Arbitration Court, Wages
Boards, and the Loan Council. A variety of marketing schemes operated
also. As such, only individual aspects of the economy and not movements of
the whole economy were regulated.
That pre-war control was only piecemeal was recognised by Australia's leading economists. For example, at a conference held in 1934 on economic planning, Roland Wilson declared:

We are already planning in Australia and we have been doing so for a long time. We have planned, by means of tariffs and bounties, the course of the country's industrial development. We have desired, planned and achieved a greater extension of secondary industry than free development would have given us. We have planned our railway systems, we have attempted to plan our oversea shipping services, and we are even now attempting to plan the development of road transport. Afforestation and irrigation schemes are planned, and the elements of planning are beginning to creep into our monetary system.

But Wilson continued by arguing:

The examples I have cited are but scattered assaults on the objective. They are unco-ordinated, they have no integrating purpose, and they have produced no body of principles to be used as a criterion of success. We are muddled in our objectives and we get muddled results. We shall continue to do so until we take more thought for the morrow.12

Similarly, E.R. Walker suggested in 1943, in terms notably similar to those of Wilson, that the pre-war economy was not only 'mixed' but 'muddled':

'Governments were never quite sure how far they should go along the path of control because they were surrounded by the clamour of sectional interests, some urging an extension of control in the directions profitable to themselves, and others arguing just as strongly for the removal of particular controls.'13 Just as Wilson complained of a lack of any 'integrating purpose', Walker concluded that the key characteristic of pre-


war regulation was the absence of any 'dominant purpose'. By contrast, the control exercised during and after World War II was a conscious, deliberate attempt to manage the economy as a whole, to regulate aggregate demand so as to achieve and maintain high production levels throughout the economy and thereby ensure continuous full employment.

a) The Labor Party and Keynesianism

It has sometimes been suggested that the acceptance of the notion of control, and Keynesianism in general, was linked fundamentally with the fact that from 1941 onwards Australia was ruled by a Labor Government and that J.B. Chifley, the Labor Treasurer and, from 1945, Prime Minister, was sympathetic with Keynesian ideas. In his biography of Chifley, L.F. Crisp points out that the Royal Commission on the Monetary and Banking Systems, in which Chifley was a commissioner, happened to commence sitting in the same month that Keynes's General Theory was published. From July of 1936 reference began to be made to the book by some of the economists giving evidence to the Commission. Chifley, under the guidance of a fellow commissioner, Professor R.C. Mills of the University of Sydney, 'was perfectly placed to gain an early appreciation of the Keynesian "revolution".... Chifley in a broad sense became a "Keynesian-of-the-first-hour"'. This fact, Crisp insists, was 'of enormous significance for Australia in the years after 1941'. Crisp has suggested also that: 'Experience and instinctive inclination had predisposed Labour men to

14 Ibid.
Keynes' approach and central theses.\textsuperscript{16} Though this is asserted rather than argued, it is true that the Labor Party had long been inclined toward interventionism. Perceiving the intransigence of bankers to be the fundamental cause of the depression, some members of the Party avidly suggested in the early 1930s that an 'inflationary' policy, entailing currency and credit expansion, be introduced. E.G. Theodore, Treasurer in the Scullin Government, harked on the need for a fundamental change in attitudes and policies. He complained:

Governments, no matter how valiantly they may have faced the problem [of unemployment] during election campaigns, are seldom able to deal effectively with it. It is the common and universal practice of Governments, almost without exception, to temporise with and palliate the evil when the crisis is at its worst, in the hope that an early revival in trade will bring at least a temporary relief to their troubles.\textsuperscript{17}

Theodore believed that palliatives were not enough. Instead, active monetary policies, designed to inflate the economy and to enable governments to finance their budget deficits, should be introduced. These suggestions came to be known as the Theodore Plan. It could be argued that the Theodore Plan was in spirit, and in part in practice, a form of crude Keynesianism. But this does not necessarily justify Crisp's claim. One must be careful to avoid labelling Theodore's ideas as being synonomous with those of the Labor Party caucus. The caucus, after all, admittedly under intense pressure from Sir Robert Gibson and the Commonwealth Bank, was later to accept the balanced budget proposals of the Premiers' Plan. More importantly, a predisposition toward interventionism does not necessarily signify a predisposition toward Keynesianism. Certainly the

\textsuperscript{16} Ibid.

\textsuperscript{17} E.G. Theodore, \textit{Unemployment and Its Remedy}, c. 1931, p. 4.
Labor Party found it easy to accept that part of the Keynesian package which called for policies designed to produce a more equitable distribution of income and for the 'socialisation of investment'. But it is not clear, if one takes the 1945-49 period as a guide, whether the Party and Chifley, despite the views set forth in the Full Employment White Paper, fully accepted the Keynesian notion of using fiscal and monetary policies in an active manner to regulate the level of economic activity. As will be argued in Chapter Five, it was not until 1951, with the Menzies Government in power, that the Keynesian budgetary approach was first explicitly adopted. Furthermore, it was under Menzies that the first break from a cheap money policy occurred and that variations in interest rates were used for anti-cyclical policies. It is relevant here to note that even in 1954 H.W. Arndt could castigate the Labor Party for the tendency of some its members to cling to balanced budget principles. He declared: 'Fallacious notions of "sound finance" according to which a balanced budget is the only sound budget, deficits are disastrous, and surpluses are misappropriation of taxpayers' money, still appear in the speeches of Labour politicians as much as in those of bank chairmen'. He also pointed out that 'there have been occasions in recent years when Labour leaders have been hardly less assiduous than their opponents in condemning Government economic controls'.\(^{18}\) Such comments, clearly, call into question the claim that Labour politicians had some sort of inherent predisposition toward Keynesianism.

It is true, however, that the Labor Party was particularly vocal

from 1942 onwards in declaring its belief that unemployment could be dealt
with by maintaining a high level of aggregate expenditure and in its
insistence that it was the responsibility of Federal and state governments
to do so. For example, in 1942 H.V. Evatt, then Commonwealth Attorney-
General, argued, in stark contrast to Lyons's pronouncements in the 1930s
on governmental impotence, that: 'With the lesson that it took the war to
teach us, we can no longer assert that the problem of unemployment is
insoluble, that men are out of work only because they are unfit or
unwilling to work, that financial policy prevents their employment, that
the task of maintaining full employment is not a responsibility of the
national Government.' 19 Similar arguments were advanced with increasing
vigour by Curtin and Chifley in parliamentary debates, radio broadcasts,
newspaper articles and election speeches. 20 Delegates of the Labor
government preached the same message to overseas audiences and attempted
valiantly to gain international acceptance of the need to ensure full
employment. 21

The UAP government, by contrast, had been notably reluctant to
commit itself publicly to a full employment policy. Nevertheless, it is
evident, from a study of the activities of a host of inter-departmental
committees, various specialist committees and study groups formed in 1941

19 H.V. Evatt, Post-War Reconstruction, (Commonwealth Government Printer,
Canberra, 1942), p. 57.


21 The Labor Government first advocated full employment as a policy goal
at the United Nations Food and Agriculture Conference in Hot Springs
in 1943. On its attempts to gain international endorsement for full
employment policies, see E.Ronald Walker, The Australian Economy in
War and Reconstruction, (Oxford University Press, New York, 1947), Ch.
16, and Butlin and Schedvin, War Economy 1942-1945, Ch. 21.
by the UAP government, that a change in attitude toward employment and the
notion of control pre-dated Labor's electoral victory. As Butlin and
Schedvin point out:

The central concern of both re-establishment and economic
committees was post-war employment prospects. With hundreds of
thousands of men mobilised and unemployment not entirely
eliminated, the vision of a return to mass unemployment after
demobilisation was vivid; it was assumed that no government
whatever its political complexion could avoid giving employment
policy the highest priority. 22

By 1943 Menzies was openly supporting the notion of control and increased
government intervention. Menzies declared in 1944 in a casual, but
nonetheless significant, aside: 'The days of uncontrolled capitalism have
gone.' 23 In a radio address in 1943 he pointed out that he believed that
the choice facing Australia in the post-war period was 'not between
unrestricted capitalism and a universal socialism'. Menzies argued that
'we have learned a great deal about how to use private enterprise for our
own social and national ends'. He was convinced that man had a deep-seated
instinct to strive for progress and reward. This was the source of
capitalist drive. But he was equally convinced that this drive should not
be left untrammelled. Instead, '[we] should seek to control and direct it
in the interests of the people as a whole'. 24 By 1949 Harold Holt could
declare, somewhat incongruously in the light of the excesses of opposition

22 Butlin and Schedvin, War Economy, pp. 626-7.
23 R.G. Menzies, in a discussion of D.B. Copland's paper, 'The Change-
Over to Peace', in D.A.S. Campbell (ed.), Post-War Reconstruction in
Australia, (Australasian Publishing Co., in conjunction with the
24 R.G. Menzies, The Forgotten People and Other Studies in Democracy,
(Angus and Robertson, Sydney, 1943), p. 144. On Menzies's attitudes
on control and government intervention, see also P.G. Tiver, The
Liberal Party: Principles and Performance, (Jacaranda Press, Milton,
1978), pp. 64-5.

154.
rhetoric during the 1944 and 1948 referenda, that: 'I make no plea for catch-as-catch-can laissez faire.... There is an important place for State planning in a modern community.' Such comments, though possibly made under the influence of political opportunism, are nevertheless significant in that they reveal that a commitment to the maintenance of high employment and, underpinning this, an acceptance of the need for some sort of control, was not restricted to the Labor Party. This in turn suggests that there are more fundamental reasons than the election of the Labor government in 1941 which are needed to explain the acceptance in Australia of Keynesianism.

b) The Legacy of Insecurity

It had been the widespread unemployment of the thirties that had impoverished and rendered empty of achievement the lives of many, and it was the fear of its return which Governments were most anxious to counter.

- H.C. Coombs, 1981

In understanding the acceptance of the notion of control two factors seem to be of fundamental importance: the insecurity caused by the depression


26 As Greenwood points out: 'Menzies was too shrewd a politician and too intelligent a man to believe that the old social order could or should emerge from the war intact.' Gordon Greenwood, 'Since World War II', Ch. 9 in Gordon Greenwood (ed.), Australia, (Angus and Robertson, Sydney, 1974), p. 420.

and the stark contrast in the employment situation during World War II consequent upon the steep increases in government expenditure. A League of Nations report, published in 1943, referred to 'the helpless feeling of insecurity, the anxiety regarding the future of dependents, the frustration of idleness, [and] the sense of counting for nothing in the community' engendered by the depression.\textsuperscript{28} J.J. Dedman, presenting the Full Employment White Paper, concurred: 'To the individual thrown into idleness by the failure of the economic system to provide employment, this failure meant poverty, frustration, disillusionment, and bitterness. Even those fortunate enough to remain in their jobs were threatened by a sense of insecurity.'\textsuperscript{29} Reflecting this insecurity and faced with the spectre of full employment occasioned by the war, pressure became intense for a governmental commitment to high employment. Australians wanted living standards raised and, above all, unemployment banished. As Herbert Burton put it in 1943: 'There is no question ... that among the great majority of people there is ... a strong and growing demand for freedom from the insecurity of slumps, from the anxiety of international rivalries and hostility, and for a more equal chance of a "good life" for all men - especially those within our own community.'\textsuperscript{30} Burton noted that 'one of the most widespread sentiments I have met in the last couple of years ... has been in effect as folows: "Now we are at war there is no unemployment, and the Government can find all it wants for war purposes. Why can't it


\textsuperscript{29} CPD, Vol. 182, 30 May 1945, pp. 2238-9.

\textsuperscript{30} Herbert Burton, 'Principles for Post-War Policy', \textit{Australian Quarterly}, Vol. 15, No. 1, 1943, p. 34.
find employment for all in peace-time?". This point was made again and again in wartime literature. For example, L.F. Giblin declared in 1943: 'The demand for maintaining a high level of employment and a minimum standard of income is so strong and general that every Government here - and in many other countries - must adopt the corresponding policies as fundamental.' The same point was made the year before in a discussion paper devoted to Article VII of the Mutual Aid Agreement. The paper argued that in the post-war world 'Australian economic policy will have to operate to satisfy a social philosophy which will demand the eradication of unemployment more forcibly than before the War', and continued: 'There will be considerable impatience with policies aimed to achieve optimum standards of living when they are accompanied by unemployment. Up to the point where the creation of employment appears to show an absolute cost there will be pressure on the Government to use available methods, of which credit expansion is one, to make jobs.' Similarly, Roland Wilson argued in 1942 in a submission to a parliamentary committee that it was not likely that public opinion [after the end of the war] will tolerate the existence of widespread unemployment, especially when people have become used to heavy defence expenditure and its effects in reducing unemployment to negligible proportions. There will inevitably be a demand for a

31 Ibid., p. 35.
33 The paper is coded F. & E. 36p. and is headed, 'Question 3. What Will Be the Possibilities of Maintaining Employment in Australia after the War by an Expansionary Policy? What are the Difficulties in the Absence of International Co-operation? How Can they be Overcome and at What Cost?' It is dated 18 June 1942.
continuance of governmental expenditure, directed to peace time ends, in order to maintain employment at or near the maximum level.34

In short, the demand for high employment and, by implication, for the government to regulate the economy to achieve this end, became particularly potent during World War II and must be seen as being of crucial significance in the acceptance of Keynesianism. More accurately, it should be seen as an essential pre-condition for the acceptance of Keynesianism. For it is not enough to want to achieve high employment. One has to have the expertise, the technical knowledge to achieve it. In this regard it would seem that the economists who joined the Commonwealth Public Service during the war were of fundamental importance. For it was the economists who claimed to have the theoretical insights and technical skills to secure full employment and who were looked upon to provide guidance in managing the economy and in achieving the permanent abolition of unemployment so earnestly desired.

c) The Economists

The publication in 1936 of John Maynard Keynes' General Theory of Employment, Interest and Money, was for me and for many of my generation the most seminal intellectual event of our time. It was not an easy book. Many of the ideas on which it was based were then unfamiliar, and the book itself showed evidence of haste in composition so that its structure did not emerge sharply from initial reading. Nevertheless, it did not fail to generate excitement from first contact, and soon I had become

convincing that in the Keynesian analysis lay the key to
comprehension of the economic system.

- H.C. Coombs, 1981

Reference was made in Chapter One to the fact that World War II was
associated with an influx of economics graduates into the Public Service.
Because of the exigencies of war and because of an insufficiency of able
administrators, many of these young graduates were able to by-pass the
established channels of promotion and assume relatively senior positions.
An important lesson for these young economists provided by the war was that
Keynes's theory seemed to have been vindicated. For the war was associated
with unprecedented leaps in the level of government expenditure and also
with a substantial decline in the level of unemployment. For those with
economics training the causal connection between spending and employment
became clearly established and the notion of economic control became a
distinct possibility. However, it seems that most of the economics
recruits were sympathetic to Keynesian ideas even before they entered the
Service. Coombs notes that when he went to Sydney to join the Commonwealth
Bank in the mid-1930s, 'I came into contact with a group of economists who
shared my excitement over the General Theory'. These included Leslie
Melville, the Commonwealth Bank's Economist, and members of the Economics
Department at the University of Sydney such as R.C. Mills, Ronald Walker,
Robert Madgwick, John La Nauze and Herman Black. Coombs came into contact
also with other economists in Sydney enamored with Keynesian ideas such as
Trevor Swan, John Crawford and Jock Phillips. He points out that: 'Mills

35 Coombs, Trial Balance, p. 3.
36 Ibid., p. 4.
arranged frequent staff seminars to discuss contemporary economic writing and at these my understanding of Keynes' developed more fully.\textsuperscript{37} There were also frequent informal discussions at local coffee shops with staff from the Commonwealth Bank, university staff and with some of the younger economists at the Bank of New South Wales, such as Leslie Bury, James Plimsoll, and Arthur Tange.\textsuperscript{38} Similarly, at the University of Melbourne Keynesian ideas were readily accepted. L.F. Giblin, Ritchie Professor of Economic Research, was 'deeply sympathetic to Keynesian thought'. Douglas Copland was also amenable to Keynes's ideas. And to the younger Melbourne economists, such as J.M. Garland, Gerald Firth and R.I. Downing, 'Keynesian theory made a prompt appeal'.\textsuperscript{39} It was among the men listed above, Coombs points out, 'that the ideas were being formulated which were to make the conduct of the war when it came and the planning of the transition from war to peace exercises in the application of Keynesian economic theory'.\textsuperscript{40}

Of fundamental importance in the acceptance of Keynesianism was the work of a wartime committee formally entitled 'The Financial and Economic Advisory Committee' but usually referred to simply as 'F & E'. F & E was originally established in December 1938 by Lyons with its chief role being to advise on the possible effects of a closure of trade routes by Japan. Membership was limited to Giblin, who was appointed chairman, Melville and Wilson. Following a suggestion by Roland Wilson in September 1939 the Committee was reconstituted, to use Giblin's term, 'on a more formal

\textsuperscript{37} Ibid., p. 5.
\textsuperscript{38} Ibid.
\textsuperscript{39} Ibid.
\textsuperscript{40} Ibid., p. 6.
The membership of the Committee was enlarged by the addition of Copland and J.B. Brigden and later of Mills, Coombs and Walker. The function of the Committee was also enlarged and made more heterogeneous. Wilson's proposal was that the F & E should 'constitute a small central "thinking committee" to which all sorts of problems could be submitted for general advice'. Its main task was 'to co-ordinate the basic economic policies of the various executive arms of the government'.

The importance and influence of F & E declined sharply after 1941. The reasons for this were implicit in its role, something which Giblin was well aware of:

The first three years of the war were naturally the period of the Committee's greatest activity. In the earlier years the need was for the establishment of general principles for the war economy, a task suited to the interests and capacities of the members. And as the war progressed, the emphasis shifted to the need for efficient administration in harmony with the established principles and in this task no Committee can be of much use. In the process of time problems sorted themselves out and found a home in new departments or sections of departments where they could receive special attention on an adequate scale.

44 Wilson, Economic Co-ordination, p. 25.
45 Giblin, 'The "F. & E." Committee'. Similarly, Butlin points out that: 'After late 1940, or, in the specialised field of finance, late 1941, [the Committee] declined in significance partly for reasons associated with its changing membership, but mainly because its essential job had

161.
Writing in 1941, Wilson pointed out that F & E was 'entirely advisory in capacity, and is dependent in the main for its effectiveness on moral suasion and reasoned argument'. Butlin notes that the views of the committee were disseminated by a variety of methods, such as 'uninhibited personal letters' by Giblin to senior administrators and by direct consultation with the Treasurer. Also of importance was the fact that most members occupied influential positions throughout the Public Service. Butlin points out that 'from the committee they took back both a better idea of how their colleagues were tackling their own jobs than any formal inter-departmental conference could have given, and a new point of view on their own tasks'.

Assessing the influence of the Committee, as Butlin suggests, is an 'extraordinarily difficult' task. Nevertheless, he is convinced that for the first eighteen months the Committee was of 'critical importance', its influence was 'powerful and pervasive'. 'Over and over again', he notes, 'it identified problems long before the officials who were right up against the details saw any problem at all, and at least marked out the chief issues which had to be resolved.' Its influence was such that 'many public servants and a minister or two came to adopt as their own, ideas and policies which had their genesis in the committee; even the phrasing of

45 (cont.) been done.' S.J. Butlin, War Economy 1939-1942, (Australian War Memorial, Canberra, 1955), p. 356. On Butlin's views on the significance of the changing membership of the committee in bringing about its decline, see p. 357.
46 Wilson, Economic Co-ordination, p. 25.
47 Butlin, War Economy, p. 357.
48 Ibid, pp. 356, 357.
nominally decisive policy documents at times had an identifiable committee source with no reason to believe there had been any direct or immediate connection'.49 Coombs, too, has no doubts about the influence of the committee. He argues: 'It was the work of this committee which gave to the economic planning of the war an essentially Keynesian character.'50 It seems essential therefore to investigate the ideas and attitudes of the individual members of F & E.

The Philosophy of the Members of F & E

The forties were very special years for several reasons. The depression and the war brought about a strong spirit of nationalism, and a desire to change things for the better. It was a creative time and social planning seemed the first essential of the new life.

- H.C. Coombs, 197451

We all came through the Second World War with a new set of principles and new ideals. This time we really believed we could build a better society. The shackles were to be struck off the unfree, colonialism was to give way to free and equal

49 Ibid., pp. 356-7. Butlin also argues that: 'throughout [F and E] had high influence as the Treasurer's adviser on financial policy and over and over again, as in the special case of the banks or the principle of the later uniform income taxation, the central idea had effective origin in the committee. The record of the deliberations of the committee is thus not only of importance as a convenient summary and bringing together of the strands of evolving government policy; its ideas were listened to. Probably even more important was the fact that a number of its leading members were influential in the formation of policy in other places'. Ibid., p. 372. The influence of the Committee is also considered in Maddock and Penny, 'Economists at War'.

50 Coombs, Trial Balance, p. 6.

51 Quoted in Rosemary Mayne-Wilson, 'Coombs: Midwife to the University, Adviser to the Nation', ANU News, July 1974, p. 2.
opportunity for all peoples, war was to give place to economic development, poverty was to give place to plenty.

- Roland Wilson, 1968

What Keynes offered Australian economists was a particular theoretical framework which encapsulated certain fundamental causal relationships and which thereby, especially when coupled with the national accounting estimates then beginning to be assembled, provided an intelligible and useful method of understanding the economy and of predicting its movements:

Keynes' achievement was to produce a simplified model of the system in which the enormous diversity of its components were grouped in a limited number of causally significant factors, and to express the relationship between these factors in language which was readily comprehensible. Given this model, it became possible by observation, by reasoning, and by intuitive judgement, to assess changes in the various factors and in the relationships between them in particular situations.

It would seem, however, that when Australian economists embraced the Keynesian model they embraced much more than even Coombs was aware of. In this section it is argued that Australian economists exhibited an outlook which encompassed all of the features of the broadly defined Keynesian model described in Chapter Three, including Keynes's philosophy of human nature. An important point which emerges is that in some respects the Keynesian model prevailed in Australia before the General Theory was published, so that in a number of instances the book did not produce neophytes but acted as a heart-warming and authoritative scripture for those who had been groping unsuccessfully for a theoretical structure to

52 Roland Wilson, 'Friendship without Tears'. Address to the Australian-American Association (Victorian Branch), Melbourne, Thanksgiving Day, November 1968.

53 Coombs, Trial Balance, p. 4.
support what they already felt to be the truth. The discussion concentrates on the writings of the leading members of F & E: Giblin, Wilson, Melville, Copland, Coombs, Brigden and Walker. The analysis is based essentially on published material written in the 1930s and 1940s.

It seems appropriate to begin with Roland Wilson, given his dominant and lengthy influence on the Treasury in the post-war period. An important source of insight into Wilson's outlook and the extent to which his views accorded with those of the Keynesian is provided by a paper he delivered in 1934 to an AIPS conference on national economic planning. Wilson was then thirty and the depression seems to have affected him considerably. Economic conditions in the inter-war period had clearly demonstrated to him the failure of the unregulated competitive system. The inter-war world was a world of '[i]dle hands, rusting machines, rotting ships, and silent factories [; a world of s]lums, ignorance, and empty bellies'. Wilson was concerned, too, at the apparent inexorable tendency for recurrent depressions to grow ever more severe:

At a time like the present, we are just a little too ready to concentrate our thoughts on the financial crisis and industrial depression through which we are now passing. We are a little too inclined to view the present condition as a mere repetition, though on a magnified scale, of the cyclical depressions to which we have been accustomed in the past. We have been disposed to endow them with a mystic quality of inevitability which, in large part, has reconciled us to their more or less regular recurrence. Resignation of this sort is likely to blind us to the increasing severity of those cyclical depressions which we have experienced in the past, and which we are likely to experience in the future. It is also blinding us to the increasing sluggishness with which the economic machine was functioning, even in those years upon which we are pleased to look back as normal. Even then there were ominous clankings

54 Roland Wilson, 'Economic Implications of Planning', p. 60.
and groanings, which a mere return to the condition of 1929 will not silence.\textsuperscript{55}

Wilson was convinced that even when depressions had been avoided it was apparent that 'the economic machine has never been geared up to the highest point of its efficiency'.\textsuperscript{56}

Wilson acknowledged that the notion of a competitive market system 'is as true as any other short description' of the Australian economic system:

We rely, in large part, upon freedom of enterprise for the organization of our economic activities, with the private appropriation of profit as incentive, and competition as regulator. Theoretically every man is free to seek out and engage in that method of applying his activities which will contribute the maximum net return to his labours. Theoretically, through the operation of a beneficent but unseen hand, the activity which will contribute the maximum individual net return will tend equally to maximize the social net product. Through the fluctuations of prices relatively to one another, it will be to the material interest of producers to apply a greater proportion of society's resources to the products of which society desires more, and a smaller proportion to the products of which society desires less.\textsuperscript{57}

The philosophical justification of the competitive market system, Wilson conceded, 'forms a theoretical conception of great beauty':

It interprets the organization of the economic activities of man in part as a response to that universal harmony which pervaded the philosophy of its progenitors; and in part as a tribute to the divine genius of man in letting well alone. It represents that organization as a machine of amazing intricacy and infinite flexibility, automatic, all-embracing and all-sufficient.\textsuperscript{58}

But the competitive market system, he insisted, was indeed only a

\textsuperscript{55} Ibid.

\textsuperscript{55} Ibid., p. 61.

\textsuperscript{57} Ibid., p. 62.

\textsuperscript{58} Ibid., pp. 62-3.
theoretical conception. It may have had explanatory value in understanding the economy of nineteenth-century England, but 'it no longer accords with the facts of the present-day world. Neither in its operation nor in its results is the competitive system justifying the faith of its votaries.' 59

There were two main reasons why the competitive system had lost any relevance it once may have had. First, the economic environment had changed considerably over the previous twenty years. The economic machine had become more intricate, more complex, with the result that decision-making was increasingly more difficult and more prone to error. The economic system was also much more concentrated: 'The individual and compensatory decisions of a host of small producers have been largely replaced by the decisions of a handful of industrial chieftains, with the result that the field for the mutual cancellation of errors has been increasingly restricted.' 60 In addition, the average standard of living had steadily increased, permitting much greater choice, and the pattern of income distribution, and hence social tastes and needs, had altered, thereby making it more difficult to forecast demand. Wilson denied the claim, put forward by adherents of the individualist philosophy, that the economic system was inherently flexible. There was no such inherent tendency; in fact the system was becoming progressively less flexible.

Second, there were weaknesses 'inherent in the system itself'. 61

For the competitive system to operate efficiently there were two key

59 Ibid., p. 63.
60 Ibid., p. 64.
61 Ibid., p. 63.
requirements: 'the economic actions of individuals must be rational and informed; and the control of the State in those matters which cannot be left to individual self-interest, must be equally rational and informed'.

Neither requirement, Wilson judged, were adequately satisfied: 'In the individual we have had to reckon with ignorance and emotion. In the State, and more particularly in respect to the exercise of its control over purchasing power, we have had to reckon with ignorance, emotion, and sometimes with a sincere but misplaced conservatism.' He continued: 'As direct consequences, the competitive system, as we have experienced it in practice, contains within itself the seeds of recurrent cycles of alternating prosperity and depression.'

The similarity which these passages provide with Keynes's writings is striking. As argued in Chapter Three, Keynes's view, too, was that the system was essentially cyclical and, as with Wilson, he was convinced that the unregulated capitalist system contained the seeds of its own instability. More importantly, both Wilson and Keynes believed that the fundamental source of instability was the fact that man was not the rational, coolly calculating creature appearing in neoclassical texts but was rather a creature whose chief characteristics were ignorance and emotion. Wilson's views on human nature were set out clearly in a

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62 Ibid., pp. 63-4.
63 Ibid.
64 The actions of the farming community demonstrated this. Wilson noted that prices in primary industry had fallen 'to unprecedented levels', and commented: 'The farmer, ignoring the economic textbooks, has tried to catch up on falling prices by increasing supply. The two processes have tended to accentuate the disparity which produced them. What has become of the automatic adjustment?' Ibid., p. 66.
discussion of some of the problems involved in economic planning:

Man may be innately good, but he is not good enough. He may be capable of improvement, but the present must take him as it finds him. It finds him still a creature of emotions, ruled by instinct rather than reason. Under the stimulus of a fine ideal he can at times rise to noble heights, but in the ordinary course of everyday life he remains the imperfect social animal. His potentialities are great, but to an extent wider than the more enthusiastic planners care to admit, they remain potentialities.... Impatience of authority, pre-occupation with detail, the accumulated class resentment of the ages, ignorance, and the consequent domination of reason by emotion - all these are factors which limit the scope of planning. 65

Keynes, however, believed strongly in social amelioration. Man was a malleable creature. Reason could replace instinct. Wilson entertained similar hopes. He declared: 'Man has got himself into the present mess, and I do not despair of his ability to get himself out again. Our troubles, after all, are due more to the failure to apply intelligence than to the failure of intelligence itself.' 66

The key means whereby reason could overrule emotion and instinct was the use of a central planning agency akin to Keynes's wise and intelligent technocracy. To Wilson, the need for economic control was obvious. Employing a particularly colourful metaphor, he argued that without control 'the economic organism will progressively lose the power to eliminate its wastes. Its absorption capacity, already lowered, will continue to decline, and its alimentary canals will remain clogged with a

65 Ibid., p. 73.
66 Ibid., pp. 77-8. Wilson had put forward a similar view two years earlier: 'I think that most of our troubles are due to ourselves and not to the machine we have fabricated to serve our ends; and the sooner we realise this the sooner will we be out of them.' Roland Wilson, 'Capitalism and the Second Effort', Australian Quarterly, December 1932, p. 58.
mass of undigested and indigestible economic resources.' He was convinced that 'society has already recognized the need for conscious control and guidance of the economic process', and continued: 'Control, of a sort, we have. Control we are going to have. The choice is between wise and unwise control.' Planning was an essential element in wise control. And planning, in practical terms, required 'the establishment of some form of central "thinking agency", which will be better equipped than the existing political organization, to direct where direction is necessary and to withhold where intrusion would be harmful'.

The sort of planning promoted by Wilson was not a form of socialistic or authoritarian planning. Wilson was supporting what he referred to as 'the newer planning', or planning of the 'newer' school. At the present stage such planning 'is more an attitude of mind than an exhortation to enter upon an immediate and obvious course of action. It impinges on social and political philosophy rather than on the technicalities of economics and finance.' Its defining characteristic, and here the similarity with Keynes is obvious, was that '[i]t urges us to seek the guidance of intelligence where hitherto we have relied on instinct'. Wilson did not seek to replace capitalism but to repair it. As he argued in 1932:

67 Wilson, 'Economic Implications of Planning', p. 69.
68 Ibid., p. 68.
69 Ibid., pp. 68-9. Clearly, it was an extension of this idea that led Wilson to urge in 1939 that a 'small central "thinking committee"', the F & E Committee, be established.
70 Ibid., p. 70.
71 Ibid.
In the capitalism that flowered in the decade before [World War I], change is now urgently necessary. But change can be secured by careful pruning and wise grafting as well as by uprooting the plant and replacing it with an exotic strain of untried suitability. By the first method we can be fairly sure of what we are getting. By the second, at best, we must wait for our fruits. At worst, we may nurture a noxious weed to run rank among our pastures, or condemn ourselves to long and patient tending of a feeble plant ill-suited to the soil. 72

Wilson concluded that to attempt to replace capitalism was 'something of a gamble', a gamble which he was not prepared to take. 'I have been forced to this conclusion', he argued, 'not because I admire the capitalistic system, in its present stage of development, but because I believe it hasn't been given a fair chance to function efficiently, and much less to realise its full possibilities.' 73

The planning envisaged by Wilson, and here again there was a notable similarity with Keynes, was insistent that there was a need 'for retaining, or even providing, the most favourable environment possible for the exercise of the higher faculties of individual personality'. Expanding on this, he declared:

The new social architects have propounded a system which they claim to be consistent with the retention of the existing framework of private enterprise. The profit motive will continue to be utilized as the most effective driving force for securing that provision of variety, and regulation of detail, which lies beyond the power of conscious direction. Competition will not be eliminated where it is required to hold self-interest in check. 74

Nevertheless, the new planning would mean that private enterprise would be 'subject to more conscious supervision and will be afforded more adequate

72 Wilson, 'Capitalism and the Second Effort', p. 58.
73 Ibid.
74 Wilson, 'Economic Implications of Planning', p. 74.
guidance than has hitherto been available'. Industry would be expected to exercise greater self-discipline. The state would have to cease its penchant for 'short-sighted economic policies'. Where automatic mechanisms did operate it was essential that the 'arbitrary and ill-conceived restraints' placed upon them by the state should be abolished. Above all, it was essential to implement 'a more vigorous and rational control of the machinery for creating and distributing purchasing power'. If it turned out that the necessary self-restraint required for effective planning failed to be forthcoming, it did not follow that planning should be abandoned; 'The remedy would be more, rather than less, planning.'

In summary, one can see in Wilson, two years before the General Theory was published, a decidedly Keynesian outlook. Wilson, as with Keynes, recognised the aesthetic and philosophical attractiveness of the neoclassical notion of a self-regulating mechanism and the encouraging message it implicitly gave: 'Everything will be for the best in the best of all possible economic worlds.' But like Keynes he could not accept such a harmonious conception as an accurate portrayal of reality. The real world, to him, was characterised by recurrent depressions, the severity of which was steadily and inexorably increasing. The economic system was seriously flawed. Moreover, the key defects were inherent in the system. Wilson traced these defects, as did Keynes, to what he took to be human nature: the tendency for people to be governed by instinct rather than reason, to be emotional rather than calculative. Nevertheless, Keynesian

75 Ibid., pp. 74-5.
76 Ibid., p. 77.
77 Ibid., p. 62.
optimism was evident in Wilson's belief that intelligence and wisdom could be applied to economic affairs by the establishment of a central thinking agency concerned with directing, manipulating, and guiding the economic system. Economic control was both possible and essential. The aim of such control, as with Keynes, was not to limit personal initiative and choice, but, on the contrary, to give it more scope as well as to produce a more equitable society.77

Wilson's model, as outlined above, encapsulated in broad terms the views of the other members of the F & E Committee. The members of the Committee were united particularly in their distrust, arising from the depression experience, of unfettered market forces. They agreed that the essential nature of the unregulated economy was that it was volatile, unstable, prone to cyclical tendencies and lacking in self-adjustment mechanisms. They agreed also that such a system could be, and needed to be, controlled.

To Coombs, the pre-World War II world was 'a world where mass unemployment is a commonplace, where businesses are wrecked in the alternating boom and slump, and where the shock absorber for the vagaries of the economic system is the health, happiness, and lives of human beings'.78 The war, however, had clearly demonstrated the possibility of

77 Another similarity between Wilson and Keynes was that both were interested in the accumulation of aggregated data for the purposes of economic management. In Wilson's papers on statistical methods and problems frequent reference was made to Keynes. Relevant in this regard is Public and Private Investment in Australia, a paper read by Wilson before Section G of the 1939 ANZAAAS conference, where he discussed the Keynesian and classical views on saving and investment.

economic control: 'It did not take us long to discover that the workings of the economic system was something within our capacity to control.... From the outset it was clear that governments were conscious that they could, by taking thought, bring into operation all the resources of manpower, equipment and materials which lay within our grasp'. The fatalism of the inter-war period had thus been abandoned: 'The fatalism which regarded the fluctuations of economic activity as something we must take for granted, and the miseries which attended them as inevitable burdens which we must patiently bear, was the first casualty of the war.'

To Copland, the pre-war world was 'a depressing picture of mass unemployment and depressed primary producers; monopoly and imperfect competition leading to an excessive inequality of wealth and incomes, and to a severe distortion of production from that most needed by society; unequal opportunities for health, education and occupation'. 'The idea of a free uncontrolled economy', he declared, 'is a "dead hand" of economic learning and thinking.' He could not accept the neoclassical notion of an atomistic economy in which the pursuit of individual self-interest produced an optimal level of output from the point of view of both the individual and society. He claimed, and here Copland was entirely in accord with Keynes's arguments in his 1937 Quarterly Journal of Economics article and in line with Wilson's philosophy of human nature, that because


81 Ibid., p. 124.
of 'ignorance, irrationality, uncertainty as to the future, and the economies of mass production, such a picture of society has never been true, and had recently become a horrible travesty of the truth'.

Copland had been making such comments since the mid-1930s. In an address to Harvard University in 1936 he argued that the depression had exposed 'the grave defects of an economic order that had no solution for economic fluctuations and no means of ameliorating the burdens of depression', and continued:

Capitalism under the control of the entrepreneur guided mainly by considerations of maximum profit is now completely discredited. It does not give economic security to the masses of the people; it does not provide economic security to the masses of the people; it does not provide the administrative machinery whereby increased technical efficiency is transformed easily into a generally higher standard of living. Countries have been able to absorb the shocks of depression and improved technique in inverse proportion to their dominance by the capitalistic entrepreneur.

The failure of capitalism under the control of the individual entrepreneur emphasised 'a fundamental fact in recent economic evolution - namely, the increasing need for state action if capitalism is to continue to yield its best fruits'.

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82 Ibid.
84 Ibid. The same point was made in Copland's 1944 address: 'It is not practicable, and it would not be progressive, to seek a return to an individual economy. What we should seek to secure is that those aspects of the productive economy which can no longer be individualist should not be in the control of private enterprise, because they give a dangerous and anti-social opportunity for exploitation, and for the perpetuation of insecurity. They should be in the control of the whole community, which is the only institution which is capable of administering them in the interests of the community as a whole.' Copland, 'Change-Over to Peace', p. 125.
Copland agreed with the Keynesian and Wilsonian viewpoint that there was no inherent conflict between the exercise of economic control and the preservation of individualistic free choice. On the contrary, he insisted that some form of economic regulation was essential for the enhancement of choice and initiative. As Copland put it:

It is not socialism which will crush the individual. It is the economy of mass production which has crushed the individual. Only if we organise ourselves to control this Frankenstein monster of industrial production - and we can do so only through as far-reaching an institution as the State, representative of the whole community - can we hope to control mass production and monopoly, avoid unemployment, and regain real individual freedom.  

In short, the regulation of private enterprise would not cramp or restrict the exercise of individual initiative and choice but would give it its first real opportunity to flourish, to be exercised without fear of insecurity. As Coombs put it: 'The history of the depression years completely destroyed the belief that insecurity is an effective stimulus to endeavour. There is nothing more stultifying to the spirit of adventure than a consciousness of insecurity.'  

Conscious and purposive regulation of economic activity by the state which aimed at providing a secure economic environment would, by implication, unleash this 'spirit of adventure' and provide a basis for the intellectual, mental, political, moral and social freedom which Copland was convinced was lacking in the pre-war world.

Melville agreed with Copland that ignorance, irrationality and uncertainty as to the future were key reasons why the neoclassical notion

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85 Copland, 'Change-Over to Peace', emphasis in the original, p. 125.
86 Coombs, 'Economic Aftermath of War', p. 83.

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176.
of a self-regulating economy was a 'horrible travesty' of the truth. Of the members of F & E, Melville was possibly the one most concerned with the methodology of economics and in particular with the inadequacy of its behavioural assumptions - although, as will be seen, Walker also was keenly interested in these topics. In his 1939 Presidential address to Section G of the ANZAAS conference, Melville considered in detail the role of expectations in economic analysis. Like Keynes, he was highly critical of conventional (neoclassical) analysis for its abstraction from uncertainty and, linked with this, its failure to pay adequate heed to expectations. Writers such as Walras, Jevons, Edgeworth, Pareto and Marshall 'sought to show that the competing demands of many people for resources could be adjusted by the price mechanism to the supply available at a moment of time'. He continued:

Most of them formulated their equations and conditions of equilibrium without any reference to the future or to rates of interest,... In formulating their theories of equilibrium economists assumed, implicitly at least, that the future was known. In formulating their theories of interest they assumed that the present was known and proceeded to discuss interest almost as if its determination was independent of the general theory of value. 87

Such theorising gave to the notion of economic equilibrium a two dimensional quality - a construct without a time dimension. Equilibrium had come to be regarded as 'something which could be considered without reference to the future, to rates of interest, and to expectations'. 88

Such comments bear a notable similarity to Keynes's post-General Theory writings discussed in Chapter Three. Interestingly, Melville

88 Ibid., p. 2.
pointed out in his address that 'Keynes has attempted to break away from
the concepts of the "classical" economists and has given us a brilliant
start in formulating a theory suitable for a dynamic world'. But Keynes
had been unable, Melville declared, to escape fully from the earlier mode
of thought. In a particularly insightful passage he argued that:

and Money, we can see him struggling to give expression to two
conflicting ideas, the one static and the other dynamic. In
his discussion of the principle of effective demand, savings
and investment, the propensity to consume, the marginal
efficiency of capital, and the general theory of interest, the
dynamic approach is struggling for expression. It bursts out
triumphantly in his discussion of expectations and employment.
However, Keynes surrenders to the equilibrium viewpoint in
formulating his statement of the general theory.... Thus,
despite the epoch-making nature of the whole book, it seems to
me that Keynes's general theory fails to break away from the
older concepts. 89

Melville was critical also of multiplier analysis. That the
multiplier principle was useful in explaining the cumulative nature of
recovery and recession was not denied. The weakness in multiplier analysis
was that it explained variations in the level of economic activity 'as if
they were merely mechanical adaptations of an economy to a change in one or
more factors. Human hopes, aspirations, expectations and failings find no
place, except in so far as they determine the pattern.' 90 As such,
multiplier analysis exhibited the same shortcomings as equilibrium
analysis.

Like Keynes, Melville believed that equilibrium analysis was of no
use in explaining or examining trade cycles. Equilibrium analysis could

89 Ibid., pp. 2-3.
80 Ibid., p. 7.

178.
not throw any light on why and when recovery turned to recession:

The economic developments with which we are concerned are not developments from one position of equilibrium to another, for the postulated positions are never attained and are in fact unattainable. Neither is economic development a trend towards an equilibrium, and it is not a fluctuation about an equilibrium, with business activity alternatively over-shooting and falling short of the equilibrium state. 91

With some similarity to the shifting equilibrium model of Keynes described in Chapter Three, Melville argued that: 'Even if a series of adjustments towards an equilibrium were commenced the adjustments themselves would so alter the data that the equilibrium would be disrupted.' 92 To Melville, clearly, the unregulated market economy was not self-adjusting. Its key characteristic was its cyclical tendencies.

As these passages indicate, Melville was impressed by the constant flux of reality and by the indeterminancy of the economic system. Also like Keynes, he deduced that economics could not, and should not, model itself on the physical sciences. These ideas were spelt out clearly in an address to the 1946 ANZAAS conference. Economists, he insisted, should not be searching for universal laws:

Economics and the other social sciences cannot provide a set of final laws or principles which will be true at all times and in all places.... The social sciences are concerned with relationships between people, depending on mental attitudes and ideas. These mental attitudes and ideas can change spontaneously and do change as the physical sciences alter the environment in which we live. Part of the data of the social sciences cannot, therefore, in the nature of things be given. It consists of a changing flux of ideas and beliefs. 93

91 Ibid., pp. 9-10.
92 Ibid.
This was not to say that there was no such thing as a 'social pattern' or that it was impossible and erroneous to make generalisations about economic processes. What had to be appreciated, however, was that 'the set of laws or principles which we know as economics - and the same is true of the other social sciences - will always be changing as the physical sciences progress and ideas and beliefs change. The emphasis and even the content of any theory of economics must be constantly altering.' Such arguments were in accord with Keynes's insistence that economic models needed constant revision and remoulding as the data of experience changed and reflected the same interpretation of the fundamental nature of the economy.

Walker was less critical of equilibrium analysis than Melville and more equivocal than the other members of F & E about whether there was an inherent tendency toward equilibrium. However, he argued in 1943 that: 'Empirical observation suggests that equilibrium is rare in practice,' and continued:

The weight of equilibrium theory suggests that failure to achieve equilibrium in practice may be due to continuous variation of the conditions of economic life; but it is equally conceivable a priori that there may be conditions which imply no tendency towards equilibrium. Since we are seeking a theory of economic development, such a possibility is not so distasteful as it may seem to the equilibrium theorist. If any set of conditions implies not equilibrium but continuous change - oscillatory or cumulative - there is no 'final' position for the dependent variables; every successive position is 'intermediate' to a subsequent one, and, though we may set out to construct a theory of market equilibrium, we finish up with a contribution (of sorts) to the theory of economic development. As with Melville, the process described by Walker appears similar to

94 Ibid., p. 194.

Keynes's shifting equilibrium model in which the economic system is forever adjusting (because of the changing expectations of economic agents reacting to disappointment) to new and unattainable equilibria. Such a system, by definition, could not be regarded as self-adjusting.

Linked with these doubts about whether a final position of equilibrium was ever possible was a belief that economics tended to simplify the complexity of human nature and distort it by concentrating on financial motives. Walker had long been an advocate of the greater use of psychological and sociological insights in economic analysis. For example, in two articles in 1930 he argued that trade cycles could not be understood without reference to psychological factors. He warned that the importance of the psychological aspect of cyclical activity should not be exaggerated. Nevertheless, it was essential 'that we recognise that it is an important factor in prosperity and depression, and that attempts to rectify our economic instability must be inadequate if the psychological aspect is neglected'. 96 Psychologists, however, had as yet 'little definite to tell [the economist] about the problem of social psychology that are so fundamental to economic analysis'. 97 In his 1943 publication, From Economic Theory to Policy, Walker argued that it was essential that economists collaborate with anthropologists, sociologists and psychologists. 98 He insisted that the assumptions of economic theory had


98 Walker, Economic Theory to Policy, p. 85.
to be modified to include other motives than the conventional one of the maximization of monetary gains. Economists had to take into account the fact that 'sentiment interferes with business',\(^9^9\) that 'much behaviour is conventional, in the sense that we never face up to the question of whether we really prefer it to doing other things or even consider whether there are other conceivable ways of spending one's time',\(^1^0^0\) that in particular societies individuals were driven by social pressure 'to conform to certain practices other than to seek the maximization of money gains, for instance, a preference for dealing with small independent shopkeepers, a preference for additional leisure rather than additional income, the hereditary transmission of occupations irrespective of the state of the labour market'.\(^1^0^1\)

In summary, those economists who made up the F & E Committee viewed the unregulated economy with deep mistrust. The economy seemed volatile, unpredictable, unstable. Underpinning this vision was a view of human nature which saw man as irrational, emotional, sentimental, subject to uncertainty and expectations, plagued with unfulfilled desires, hopes, aspirations, enveloped by group pressures, acceding to social conventions and traditions.

In such a capricious, insecure world some form of economic control seemed essential. Brigden could comment in 1935:

The depression has brought out in dramatic fashion a general

\(^9^9\) Ibid., p. 83.
\(^1^0^0\) Ibid., p. 90.
\(^1^0^1\) Ibid., p. 86.
opinion already existing, and although we must discount the greater part of contemporary change, both in opinion and in practice, the trend of thought is an economic fact. Emphasis is passing from the alternative human desires for adventure to those for security, from progress to order, from freedom to discipline, and from competition to control.102

Though ideas as to the meaning of control varied from member to member and over time, the individuals who constituted F & E agreed that the notion of control should embrace action by the state designed to maintain outlay at a level sufficient to ensure continuous high levels of employment, to maintain business confidence, and to banish economic insecurity. The maintenance of outlay at full employment levels required conscious, deliberate, planned, purposive action and, underpinning this, the use of an economically literate technocracy to advise on appropriate strategies.

In their emphasis on the level of aggregate demand as the fundamental determinant of employment, F & E members were decidedly Keynesian. From the start of the war the F & E Committee stressed the need for increased spending to ameliorate the employment situation. In 1939 Giblin announced in an F & E memorandum, in defiance of the established fatalism, that: 'The prevention and cure of unemployment is in a country's own hands.'103 In October of that year, in a paper entitled 'Unemployment', Giblin discussed the views of the F & E Committee on the apparent increase in unemployment which had occurred in both the June and September quarters of 1939. Unemployment was likely to become an 'acute


102 L.F. Giblin, 'Winning the War', Australian Archives, AA 1968/391, Item 139.
embarrassment' to the government. He argued that: 'The difficulty can only be met by spending - not planning, or commitment or raising loans, but spending; and spending for employment as much as and more than for defence.' Here was one of the earliest attempts to push onto the UAP Government a distinctly Keynesian line. Giblin conceded that what he was suggesting 'would involve a complete reversal of the traditional Commonwealth policy of regarding employment as solely a State responsibility'. But he insisted that: 'It would ... be sounder policy - and possibly sounder politics - for the Commonwealth to lead from before instead of being pushed from behind.'\(^{104}\)

Throughout the war frequent reference was made in the writings of F & E members to the fact that the war had demonstrated the importance of conscious action by the state to maintain an adequate level of demand. Writing in 1945, Giblin argued that a novel feature of economic thought as it had evolved up to the end of the war was 'the recognition that outlay will not maintain itself at the appropriate level [to ensure full employment] and that it is the duty of governments to take measures to ensure that it is so maintained'.\(^{105}\) Here again was the persistent theme of the economy's failure to be self-regulating. Giblin continued:

> Before the last war it was generally believed - and on quite reasonable evidence - that there was an automatic tendency in any economy to maintain outlay at something near the appropriate level. It is only since then that experience under the between-war conditions, showed that the automatic adjustment was tragically insufficient to maintain outlay; and on that comparatively recent experience the need of Government

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\(^{104}\) L.F. Giblin, 'Unemployment', 17 October 1939, Australian Archives, CRS A571, Item 39/3799.

Writing in 1943 on post-war reconstruction, Giblin could claim that there was 'fairly general agreement about the immediate causes of unemployment and their remedies'. He distinguished between general unemployment, structural unemployment and seasonal unemployment. In explaining the causes of general unemployment Giblin was straightforwardly Keynesian: 'The trouble here is that incomes are not being fully used in some way and that savings are made which are not actively invested. The fall in investment makes unemployment and is followed by a fall in demand for consumption goods which is cumulative.' An interesting feature in this passage was the notion of a cumulative decline in demand. Here was yet another element of the Keynesian model. Giblin was in fact a pioneer of the multiplier principle and had first propounded the concept of a multiplier in 1930, some twelve months before Kahn's famous article in the *Economic Journal*. Although Giblin's multiplier was a foreign trade multiplier while Kahn's was an investment multiplier, the principle was notably similar. The multiplier principle and the notion of cumulative change was quickly accepted and adopted by Giblin's fellow economists and by his students.

106 Ibid.


109 For example, in an article on unemployment in Australia written in 1932, Wilson pointed out that: 'The precipitous fall in world...
Giblin was keen to point out in his writings that the maintenance of a high level of outlay was a necessary but not sufficient condition for the achievement of employment. What was required in addition was, as he put in 1945, 'something like a revolution in the canons of conduct of a large proportion of any people'. The members of F & E were adamant that the success of full employment policies would depend ultimately on the achievement of a social consensus. They felt that greater self-discipline be imposed and that a less selfish, more altruistic, more community-minded attitude be created. This, as will be seen, raised important questions about the malleability of human nature.

The need for a change in community attitudes had been recognised and debated among a broad spectrum of Australian intellectuals since the early 1930s. As Tim Rowse points out, an important shift in the trend of philosophical discussion occurred in Australia in the 1930s, which was particularly evident among the members of the Australian Institute of Political Science but also, as indicated earlier, among leading Australian economists, and which involved the death of rational economic man and a

109 (cont.) commodity prices, particularly in the prices of agricultural and pastoral products, found Australia singularly ill-prepared, and dealt a staggering blow both to private and public incomes. So great and rapid was the fall in the prices of exported products that almost at one stroke a large part of the income of export producers was wiped out. But the damage did not stop here. The initial losses of income soon showed their effects in a diminished demand for the goods and services of other producers, and so was set in motion a series of successive contractions throughout the Australian economy.' Roland Wilson, 'Unemployment in Australia', Supplément de la revue Les Assurances Sociales, ann. 9, no. 6, November-December 1932, p. 51.


111 Tim Rowse, Australian Liberalism and National Character, (Kibble Books, Melbourne, 1978), Ch. 4.
recognition of the essential irrationality, imperfections and complexity of human nature and behaviour. Linked with this change, and here Walker and Melville can be seen as being representative, were pleas for the adoption of a holistic social psychology to probe and examine social life and, more fundamentally, to bring about a change in human consciousness and aspirations. As Rowse puts it: 'the intellectuals of the 1930s and 1940s, after recovering from the shock of finding that rationality was a dominant quality only in a restricted social enclave, began to emphasize the possibility of harnessing the manifest imperfections of social beings to efficiency to a psychologically subtle propaganda; from social a common purpose.'

The views of J.B. Brigden provide an important insight into the trend of intellectual thought, and of the views of the members of F & E, in the 1930s on the malleability of human nature and on the possibility of social consensus. Writing in 1932 on 'Economics and Ethics', Brigden insisted that it was time to realise, given an evident trend toward collectivism, that the question of 'Social Will' was of crucial importance:

The twentieth century is forcing upon us a new collectivism. Whether it shall be of numerous rival groups, each individualistic to the core, or whether it shall be pervaded by a sense of social unity [which Brigden hoped it would], depends entirely on the individuals. 'Social Will' is not some mystic thing arising from the mass; it is the aggregate of individual Wills. We wait for it to grow, in small things first. We wait for it to achieve unity and discipline, not in specific policy, but in a 'point of view'. We wait for moral leadership, and for the practice that begins at home. Social control will not come effectively through State action, for the machinery of State is already overloaded. It can only come through a general growth of voluntary and co-operative consideration, one interest for another. And the moral leadership which may bring it forth is not likely to be a personal one. It must be

112 Ibid., pp. 156-7.
widespread and pervasive.\textsuperscript{113} Brigden complained that those characteristics which seemed so essential to him for the individual voluntarily to acquire - unity, discipline, consideration, co-operation - were not being encouraged by economists. In fact, economists were 'to blame for the concentration of public attention upon organisation, rather than upon Will'.\textsuperscript{114} Economics, unlike its parent discipline, moral philosophy, had 'grown hard, statistical, scientific, immoral'.\textsuperscript{115} Economics had been insufficiently concerned with what ought to be, being preoccupied with what is.

Brigden was to take up these themes again in 1935 in his Presidential address to Section G of the ANZAAS conference. The economic system, he noted, was becoming increasingly unstable, essentially because the world was becoming increasingly complex: 'It is a commonplace that complexity and vulnerability go together. The more highly developed an organism becomes the more liable it is to disorder.'\textsuperscript{116} Reflecting the failure of attempts in the 1930s to obtain greater international co-operation, Brigden maintained that: 'It is easier for every one to get into a depression because economically the world is one place, and it is harder to get out of it because politically we are all insisting that the world is a number of quite separate places.'\textsuperscript{117}

\textsuperscript{113} J.B. Brigden, 'Economics and Ethics', \textit{Morpeth Review}, Vol. 2, No. 22, December 1932, p. 20; emphasis in the original.

\textsuperscript{114} \textit{Ibid.}

\textsuperscript{115} \textit{Ibid.}, p. 16.

\textsuperscript{116} Brigden, 'Competition and Control', p. 234.

\textsuperscript{117} \textit{Ibid.}
If instability was to be overcome, it was necessary to recognise that the profit motive was an insufficient and improper guide to, and rationale for, economic life. In a revealing passage, Brigden outlined the sort of world he would have liked to see replace the existing one:

Economists, being human, have their Utopia, too. Theirs is an economically-minded world in which the business community shall have acquired a sense of social responsibility, and where bankers at least will have become supermen, able to understand what to do when this Section shall have discussed some monetary problem. We should like to see a world where every large business gave an account of its stewardship in sufficient detail for it to be judged, and by a public interested and wise enough to pass judgement. We should like to see a banking and investment system international enough, strong enough, and bold enough to say 'No' when booms threaten, and competent enough to know when to do it. We should like to see the difficulties of the problem appreciated.118

Whereas the neoclassical behavioural ideal is a world of calculative, deliberative, independent, autonomous creatures, Brigden's ideal was a world dominated by the concepts of social responsibility and public accountability. There is also in Brigden's Utopia an emphasis upon self-improvement and heightened intellectual capacity: what is required is understanding of technical issues, interest and wisdom to pass judgements, competence to know when and what to do when a boom is apparent, an appreciation of economic difficulties. Moreover, unlike the neoclassical ideal, Brigden's desired behavioural characteristics were not inherent but had to be acquired. Somewhat pessimistically, Brigden appended to the passage above: 'But these are Utopian aspirations. Human nature is not yet built that way.'119

However, other passages in his address indicate that Brigden was

118 Ibid., pp. 236-7.
119 Ibid., p. 237.
not without hope. Of particular interest is the following passage:

It required the Great Depression to start the idea of preventing the recurrence of depression. It always requires a great catastrophe to bring about a very radical reform. The powerful weapons of commercial propaganda may... be used in the cause of general economic health. Central Banking is gaining great strategic power, and may be able to use it in a crisis with such a backing. It may lead to a real 'money power', inspired by a full-grown professional and scientific spirit, and able to maintain the confidence of both the investing public and the general public. Given such an authority there could develop all the discipline that is necessary and practicable for stability, economy, and progress. The machinery is relatively unimportant.

This is the strategy for progress. It implies a recognition by business men that the profit motive is inadequate. That is to ask a great deal. It implies a recognition by others that political and legal force is as futile as physical force. That is to ask very much more. It implies co-operation and a new leadership. That is to ask for a miracle. Nevertheless the first may come from experience, the second from disillusion, and the third from necessity. 120

Here again the hope is for co-operation, for self-imposed discipline (that which is externally forced being considered ultimately impotent), and for a downgrading of the importance of pecuniary motives. There is also hope - and here Brigden seems to have some resemblance to Wilson's concept of a central thinking agency - for the establishment of a central banking authority embracing sufficient professionalism and technical expertise to inspire confidence among economic agents.

Brigden's overall conclusion was one of tightly restrained optimism that these hopes might eventually come to fruition: 'The conclusions are that economic motive power is the dominating problem, that it could be managed with an appropriate technique, but that no such technique is possible until popular ideas have advanced out of their present infantile

120 Ibid., p. 239.
Giblin, even by the end of World War II, was a mixture of optimism and pessimism on the question of human malleability. Discussing the possible fate of attempts to secure full employment in the post-war period, Giblin argued in 1945 that 'the crux of the matter is the conduct of individuals. Most of us will need a new outlook. As of old, the Kingdom of God is within us.' Giblin believed that: 'People, in general, are reasonable enough, and as individuals mostly they can be counted on to play the full employment game.' But when individuals belonged to organised interests they acted quite differently: 'Organizations seem to collect all the vices and reject all the virtues of their members. Organized interests are in fact Satan's last and cleverest invention for the destruction of mankind.' There were also problems that were peculiarly Australian. Giblin was convinced that the British were 'more responsible and more realistic' than Australians. 'The Australian', he insisted, 'is very given to romantic notions about everything concerned with production, and particularly about money.' Australians, perhaps not surprisingly, were also much less united:

One would not expect much uniformity in public opinion with seven million people sprawled over three million square miles. Moreover they are segregated into States with most of their interests centred on the State capital. In peace-time the Commonwealth government and parliament are Sunday matters; for the working week it is the State administration that

121 Ibid.
123 Ibid., p. 60.
124 Ibid., p. 61.
Of key importance in explaining why forty years of federation had failed to create 'greater community of feeling' was the role of newspapers 'whose interest is to magnify the State office':

Each is on the doorstep of its own State government, and business interests are concerned with State legislation and administration. It may be said broadly that there is no daily paper in Australia that consistently maintains an Australian outlook. They are all (with one possible exception) essentially 'provincial'. Even the weeklies and monthlies (except the Sunday Bulletin) find it hard to cross State boundaries. Radio broadcasting is doing something to flatten the boundaries but serious opinion and outlook over the air are, again, Sunday matters.  

On the fate of Australia's attempts at a full employment policy, Giblin concluded that: 'Immediate success seems to me not impossible, but uncertain. At the worst, however, I can see the prospect of ultimate success.' The worst possible scenario was as follows:

We will assume that a full employment is resolutely but soberly attempted, but organized interests go their accustomed way, with all take and no give. Discipline weakens, and productivity falls in factories and on farms. An increasing army is engaged in unproductive labour at high wages or sitting back on full wages as unemployment benefit. The electorate rejects all attempts at discipline, and responsible leaders give place to demagogues, ready to promise a dozen moons. Things go from bad to worse.... [Eventually t]he chickens come home to roost, and most people realize the degradation of their standards, material and moral, which has taken place. Having good stuff in them at bottom, they recognize that they have been fools, and are ready to face the unpleasant job of working out their redemption.  


126 Ibid.


128 Ibid.
Salvation comes via the educational system:

Meantime one good thing had come out of the war and reconstruction - a new vision in education - and that had persisted through all the employment difficulties. Its realization had been slow; old teachers had to be weeded out and retrained, before we had even the machinery for an education directed to turning out good and competent citizens. Of course, countless mistakes had to be made and corrected. So it was not till about 1960 that the products of the new education were being turned out in numbers enough to carry weight. It was about this time that the older members of the community had become thoroughly disillusioned about easy paths to the golden age and were ready to face the mountain tracks, if someone would show the way. Under these circumstances the old and the young, joining experience and a clearer vision, begin to put things together again and about 1965 the full employment policy is launched again and this time is found seaworthy. 129

As with Brigden, social consensus arises ultimately from disillusion, experience and necessity. According to Giblin, people have faults, certainly, but they are malleable. With persistence and with the passage of time people can eventually be remoulded to embrace community-minded ideals. In this reformation education is the ultimate weapon. Effective leadership, possibly along the lines of Keynes's wise and intelligent technocracy, is also crucial.

Melville, too, was aware of the need for a change in attitude for full employment policies to be effective and was convinced that such a change could eventually be brought about. One can see this clearly in the following passage, written in 1942, in which Melville stressed the need for 'education', for 'changing mentalities', for achieving 'co-operation', for 'overcoming jealousy', for 'gaining interest', for 'persuading' ministers to change their attitudes:

If government spending to eliminate unemployment is to be

129 Ibid.
useful, there is a lot of work to be done before the next slump
and, in the years reckoned according to the democratic
calendar, very little time available in which to do it. We
have to educate the public so that investors already curtailing
their activities with the onset of depression will not further
curtail them through fear or of the consequences of government
spending or through active hostility to the attempt to avoid
unemployment in this way. We have to change the kind of
mentality prevalent in both civil service and business which
refuses to do today what can be put off until tomorrow — the
'one hurdle at a time' sort of outlook. We have to overcome
obstacles to co-operation between Commonwealth and States,
government and industry, and one government department and
another. Since the plan must be conceived as a whole, we must
overcome the jealousy of some public servants towards anyone
who has the temerity to make plans themselves, either because
they are overwhelmed or are actively hostile to any form of
planning.

Finally, we have to gain the interest of ministers, prevail
upon them to take an active part in forward planning, and try
to persuade them to ignore sectional interests while they do
it.130

Implicit in Melville's comments was a belief that what ought to be could be
achieved. But exactly how this change would come about was not
explained. In particular, the identity of the 'we' who educate, who change
mentalities, who overcome and who persuade, was not given.

On the question of social consensus, Copland was convinced that the
war 'has done a good deal to restore unity of purpose among democratic
peoples'.131 He felt that there were strong grounds for confidence that an
improved organisation of economic society could be achieved in the post-war
period because, among other things, there existed 'a great mass of
inarticulate opinion which could be brought into play, if properly
organised and tutored, to support a constructive economic policy'.132

130 L.G. Melville, 'Economics of New Orders', Economic Record, Vol. 18,
131 Copland, 'Change-Over to Peace', p. 122.
132 Ibid., p. 123.
However, he warned against over-enthusiasm about the possibility of such change occurring.

Coombs was the most optimistic of the members of F & E about the possibility of achieving social consensus. With some similarity to Copland he argued in 1944 that: 'The war has created, at least at certain moments of its progress, a consciousness of social unity. That consciousness has not been sustained always at the same high level, but it is there, latent, and I believe ready to respond to calls upon it to achieve purposes sufficiently close to our national ideals.'\textsuperscript{133} The war-weary population, he was convinced, was 'anxious for change and willing to be inspired into social unity for a common purpose'.\textsuperscript{134} On the basis of this belief, Coombs concluded that there were strong grounds for confidence that a full employment policy would succeed. He judged that the technical aspects of maintaining full employment would present no great difficulties.

In summary, the outlook of the members of the F & E fitted closely the Keynesian outlook described in Chapter Three. Their views on the essential nature of the unregulated economy, on the nature of economic agents, and on the notion of control were notably similar to those of Keynes. The committee's outlook was to be modified in subsequent years but an analysis of Australian economic literature in the 1950s and into the 1960s, including that of the Treasury, reveals that the underlying assumptions of its members were widely accepted among the Australian economics profession. Theirs was to be a remarkably durable legacy.

\textsuperscript{133} Coombs, 'Economic Aftermath of War', p. 78.
\textsuperscript{134} Ibid.
Although F & E was transferred to the Treasury in September 1939, the Treasury did not openly embrace the committee's ideas. In fact, the committee's approach to economic policy was seen as being quite distinct from that of the Treasury. S.J. Butlin refers to 'Spender's willingness ... to seek advice and views from the Financial and Economic Committee, and his readiness to discuss issues with its chairman rather than to accept the traditional approach of Treasury officials.'\textsuperscript{135} Spender confirms this in his autobiography. He acknowledges in particular the assistance of Giblin in formulating the revised budget of December 1939 and notes that: 'In reaching my views I consulted advisers outside the Treasury; action hardly pleasing to the department.'\textsuperscript{136}

This displeasure was the result not just of damaged pride (by seeking outside advice Spender had violated the Treasury's conviction that on budget matters it was the highest authority), but because the views of the committee represented a threat to the conventional wisdom. As noted, Spender complained that the budget of September 1939 presented to him by Stuart McFarlane, Secretary to the Treasury, 'followed traditional patterns. It contained no statement of principle. It indicated no new financial doctrine or idea.... This was a "business as usual" budget.'\textsuperscript{137} Spender was proud of the fact that the revised December budget 'broke away from the orthodox'. The essential problem as he, and F & E, saw it, was

\textsuperscript{135} Butlin, \textit{War Economy}, pp. 214-15. See also pp. 199 and 316-17.

\textsuperscript{135} Spender, \textit{Politics and a Man}, p. 44.

\textsuperscript{137} \textit{Ibid.}, p. 42.
'not in terms of money but in material and human resources'. Such a view, he acknowledges, 'was greeted with considerable doubt and criticism'.

In light of McFarlane's approach of only two months earlier, there can be no doubt that the Treasury joined with those who disapproved of Spender's and the committee's ideas. Coombs confirms this. He points out that at the beginning of the war, with unemployment running at about 10 per cent, F & E advised Spender that the increase in expenditure provided for in the revised December budget did not have to be matched by an increase in taxation. The Treasury, by contrast, believed an immediate rise in taxation was necessary. Coombs, who had recently been appointed Treasury economist, declared his support for the F & E approach at a meeting convened in 1939 by Spender and attended by McFarlane. McFarlane's reaction to this was one of anger. As Coombs recounts: 'after we left Spender he told me I had no right to express opinions so inconsistent with the Treasury view (my first encounter with this concept) which it was his responsibility to determine'.

Menzies summarised the Treasury's early war-time approach in a memorandum presented in March 1940 which described the divergent approaches of a number of departments to the economic problems presented by the war. The Treasury's approach presented a marked contrast with the ideas of the committee. The Treasury's only concern was with financial matters. Its aim was 'to maintain investible funds so that public loans may be filled; to keep interest rates down; and to encourage

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138 Ibid., p. 44.
139 Coombs, Trial Balance, p. 7.
140 Ibid., p. 8.
the stability of industry so that taxation yields may be high'. Paul Hasluck has also pointed to the Treasury's preoccupation with financial matters in the early years of the war. The department's approach, he notes, was thoroughly traditional: 'In the first year of the war its attitude was unimaginative and conservative and there are many stories to be heard from wartime administrators of senior Treasury officials who were still boggling at every thousand pounds of additional expenditure when war departments were talking in millions.'

One must be careful, however, despite McFarlane's comment that he was responsible for formulating the Treasury view, not to assume that McFarlane, and the financial orthodoxy he embodied, was totally representative of Treasury attitudes. As described in Chapter One, World War II was a time of considerable flux for the Treasury. It was associated with the adoption of responsibility by the department for economic, as distinct from financial, management, by the recruitment of economics graduates, and by the establishment in 1943 of the GFEP Section. It can be expected that the economic recruits were not always intellectually and temperamentally in accord with McFarlane and possibly on occasions sought to change his views. It can also be expected that given their age and

141 Quoted in Butlin, War Economy, p. 214.


143 Referring to his relationship with McFarlane, Coombs notes that 'both intellectually and temperamentally our approach to economic and financial problems continued to be divergent. But I had genuine respect and affection for him and we both came to enjoy the discussions in which I argued for the views which were being developed in the Finance and Economic Committee and he probed them Socratically. I believe he found our collaboration valuable.' Coombs, Trial Balance, pp. 8-9.
given their economics training the steadily increasing stream of recruits would have been amenable to Keynesian ideas and to the approach of the F & E Committee. It is interesting in this regard to consider the following passage from a Treasury memorandum written in mid-1941:

The fundamental aim of post-war society should be the maximisation of the community's social welfare. Opinions will differ as to what constitutes maximum social welfare but we can ... take it that the maximum possible real National Income, i.e. the maximum standard of living, is an essential prerequisite.

The minimum of unemployment is a necessary condition for a maximum Real National Income but it is by no means the only one. The nature of the output produced by an economic system in full employment may vary and it will be necessary to ensure that our post-war output does provide the basis for a maximum standard of living.... If the making of roads which are at present unnecessary is the only means of providing employment for a section of the community, then it is desirable to make these roads. But if possible those men should be employed in the production of something which the community needs more urgently, say hospitals. 144

Although the tone is guarded, this passage demonstrates that at least among the new officers there was an acceptance of the F & E line that the government could and should aim to achieve a high level of employment and that the key means of achieving this was by maintaining output at a sufficiently high level. Although it is true that the Treasury engaged in a protracted dispute with the Department of Post-War Reconstruction over the contents of the Full Employment White Paper, 145 the Treasury did accept fully the contents of the final draft and, in fact, it seems it had a key role in the final drafting. 146

144 Quoted in Butlin and Schedvin, War Economy, p. 627; emphasis in the original.
145 For the details, see Cornish, 'Full Employment in Australia', especially pp. 107-9, 136-9, 156-7, 168-9, and 171-2.
146 Frederick Wheeler, the head of GFEP and the leader of the Treasury's negotiations over the White Paper, could declare in March 1945 that he
The analysis in subsequent chapters reveals that throughout the 1950s (the appointment of Roland Wilson as Secretary to the Treasury in 1951 seems to be a turning point), and into the 1960s there was a notably similarity between the Keynesian views of the F & E Committee and that of the Treasury. The similarity was not restricted to an acceptance of the notion of control. It embraced also a conviction that the unregulated economy was fundamentally unstable and that economic agents, though essentially irrational, were capable of continuous improvement so that a more orderly, more resilient, more stable, more secure economy could be achieved.

146 (cont.) was 'in agreement with the central policy of the document [the final draft had not yet been written], i.e. the seeking of full employment through the maintenance of total expenditure by: (a) Measures to stimulate and stabilise export income and private investment. (b) Compensating variations in the amount and direction of public investment.' Quoted in Cornish, 'Full Employment in Australia', pp. 136-7.
The economics graduate of the 1940s, of whom I was one, walked toward the light with Keynes in one hand and Beveridge in the other, gratefully turning his back on the Marxian spectre of misery and mass unemployment of the 1930s. He approached his task as a teacher or public servant or business executive confident that appropriate remedies were at hand to deal with the economic and social ills which might befall the country from time to time.

- J.E. Isaac, 1977¹

The previous chapter argued that the broadly defined Keynesian model had been accepted among Australia's leading economists by the end of World War II. The present chapter outlines the evolution of that model from 1945 to 1956. The discussion is predominantly an analysis of the annual budget speeches and key parliamentary financial statements presented in the period under review. Accordingly, the focus shifts from the views of the F & E economists on the nature of the economic system to the views of the government and, given the department's responsibility for drafting budget speeches and financial statements, of the Treasury. The focus shifts also from an examination of the acceptance of the notion of economic control in principle to an examination of the use of Keynesian budgetary and monetary regulation in practice. The chapter begins with a brief study of budgetary theory as propounded by the F & E Committee and by the Treasury. It then analyses the budgetary thought and practice of the Chifley government (1945-49) and of the Menzies government up until the mini-budget of March 1956.

In the library of the Australian Parliament at Canberra there is a copy of the General Theory. The first three hundred pages, in which the theory is worked out, are of virgin whiteness; the last eighty pages, with the practical applications, are well thumbed and heavily scored.

- E. Ronald Walker, 1943

As the 1930s progressed there was in Australia an increasing trickle of advocates of Keynesian-type budgetary principles. The most notable of these was E.R. Walker. Writing in 1933, he lamented the fact that the Keynesian argument, that during a depression the government should budget for a deficit, had not gained wide acceptance. By 1936, however, Walker had reached the view that the policy adopted in various countries, of spending on public works at the same time as preserving balanced budgets, was defensible in a context of unemployment. Such a policy was defensible because it was unlikely that public works spending would 'prime the pump' while people's confidence was shaken by the presence of unbalanced budgets. He argued that: 'Such is the general state of knowledge that if a government wishes to enjoy public confidence it must either balance its budget or make a great show of effort in this direction.' This was essentially the approach adopted by Walker in evidence before the Royal

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5 Ibid., p. 170.
Commission on Money and Banking. If, he argued before the Commission, one could abstract from the psychology of the business community and think purely in terms of the mechanical flow of money and purchasing power, an increase in the budget deficit was essentially the same as an expansion of loan expenditure, the names given to the two actions being the main difference. But the fact was that the reaction to the continuation and/or expansion of budget deficits was one of suspicion and lack of confidence. If this could be removed, if the general level of economic education could be raised, then the desirable policy to pursue would be to budget for deficits during depressions and for surpluses in booms. If the depression was protracted there was no sanctity in annual balancing or even balancing over a two or three year period. Nevertheless, Walker deemed it 'highly desirable' that ordinary current expenditure be balanced over a 'long period', that is, over the length of the cycle. This long-term balance was essential for the purpose of public finance administration. However, by 1939 he could argue that: 'Slavish adherence to budget balancing over any definite period may be inconsistent with the maintenance of full employment.' In his opinion, under cyclical budgeting the position would eventually be reached, as in annual budgeting, where there would be a need to choose between budget balance and full employment. To opt for full employment might necessitate abandoning even long-term budget balance. Walker was aware that such a proposal was 'regarded by distrust by the very conservative': 'To dismiss the insistence on balancing of the budget even


7 E. Ronald Walker, 'Sound Finance', Economic Record, Supplement to Vol. 15, April 1939, p. 63; emphasis in the original.
over longer periods and to condone a long period deficit in order to maintain spending in periods of depression is regarded as extremely radical and contrary to sound finance.'

Nevertheless, a change in opinion on the role of the budget was slowly becoming apparent by the second half of the 1930s. It is interesting in this regard that the Royal Commission on Money and Banking endorsed Walker's views, arguing:

In general, the proper policy for the governments to pursue if a depression is developing is to expand public works, refrain from increasing taxation, and avoid a general contraction of government expenditure, even although deficits are incurred. When conditions have improved as private enterprise revives and full employment is approached, the proper policy is to contract public works expenditure, maintain or increase taxation, budget for surpluses, and reduce the debt which has been incurred through the depression policy.

The views of both Walker and the Royal Commission are significant not just for their break from the orthodox financial dogma of annual budget balancing, but because such views represent an early acceptance of Keynesian-type government economic management. The Commission emphasised that its recommendations required action from the government in times both of depression and recovery. It was 'wholly unwise' to wait until a boom or depression arrived before action was taken. The Commission insisted that 'the extent to which measures have to be taken when a depression develops will largely depend upon the extent to which proper action has been taken in the earlier stages'.

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8 Ibid., p. 62.


During the 1930s, however, such views were uncommon. As C.B. Schedvin points out, one of the most remarkable features of the 1930s was 'the absence in Australia of any significant intellectual or official dissatisfaction with established policy doctrine'.\(^{11}\) On the eve of World War II, Walker was still complaining that peace-time finance was too conservative and war-time finance too radical: 'less emphasis on budget balance in peace and more in time of war is required'.\(^{12}\)

With the onset of World War II, the F & E Committee was quick to recommend a departure from financial orthodoxy and advised Spender in December 1939 that, given the existence of a high level of unemployment, defence expenditure could for a time be increased without any need for an commensurate rise in taxation revenue. With real resources fully mobilised and inflation the key problem, the Committee urged that taxation be increased and that a variety of direct regulatory measures be introduced as war-time expedients: price stabilisation, the rationing of essential consumer goods in short supply, the establishment of priorities for scarce materials, and the imposition of certain limitations and conditions on civilian production and on the use of manpower. Share prices, land sales, interest rates, rents, wages, capital issues and bank advances were also regulated.

The principles which the committee thought should apply to budgetary policy in conditions of unemployment were set out by Giblin in a


1945 article in which he argued that, given a situation in which total outlay was at an insufficient level for the maintenance of full employment and given the consequent need for the government to bring about an increase in outlay, there were three main methods which the government could use to meet this need. Two involved budgeting for a deficit. The three methods were:

(a) by increasing government expenditure financed by loan; (b) by increasing government expenditure financed by taxation; (c) by maintaining government expenditure at its present level, reducing taxation, and financing the deficit by loan.

Giblin argued that the most useful method would be (a), although in certain circumstances it could be combined with (b) or (c). He suggested that in some special circumstances, which he was vague in specifying, methods (b) or (c) alone might be desirable. 13

Within the F & E Committee it was believed that monetary policy was limited in its ability to regulate both boom and slump conditions. As Melville argued in 1942:

Any practicable contraction of credit or raising of interest rates seems unable to restrain a boom. If their expectations are sufficiently optimistic, business men have their ingenuity to carry on despite a reduced supply of money. They create other credit instruments for the purpose and pass on the available money more quickly from one to another. High rates of interest do not affect their costs sufficiently to matter. There is a real danger that the attempt to control booms in this way may be continued long enough to intensify the depression. 14

With regard to slump conditions he insisted that: 'The means of eliminating unemployment are not, it seems, to be found in the monetary


system.' Echoing Keynes's views in the *General Theory* he argued that 'when confidence is shattered and expectations are gloomy, no amount of credit and no interest rates, however low, seem able to tempt business men into renewed activity.' But this was not to suggest that monetary policy was of no use and should be abandoned as a means of economic management: 'That is not to say that a suitable monetary policy cannot help to iron out booms and slumps. But we cannot expect by that means to eliminate unemployment, while if we do nothing more we must be prepared at times for long wasting depressions.' What was essential was an active fiscal policy.

It is difficult to judge the extent to which such arguments were accepted outside the F & E Committee. The *Full Employment* White Paper provides little insight. A notable feature of the White Paper was the scant attention given to the question of public finance. The Paper announced that as the government intended keeping total expenditure high it would have to have the necessary finance. This should come mostly from taxation (presumably both direct and indirect). Though taxation was subject to limitations as a revenue source, it was believed that these limitations would not prevent taxation being levied at a level which would enable the yield from incomes when the economy was operating at a full employment to cover at least all current public expenditure (including maintenance) as well to make a contribution to public capital expenditure. But the budgetary consequences of this were quite vague. All that the Paper contained were references to general principles such as avoiding tax rates that were 'too high', avoiding variations more than were 'inevitable'
so as not to aggravate the public, minimising the restrictive effects of taxation and endeavouring to achieve a higher degree of equity. Nevertheless, given the government's belief that taxation would not be able to provide all of the necessary revenue, it is clear that the likelihood of deficit financing was envisaged (though this was not mentioned explicitly). In line with this, the Paper noted that borrowing from either the public or the central bank could be used to provide necessary finance. The major problem with public borrowing, however, was that it entailed an interest burden. As for central bank finance, though useful up to the point of full utilisation of men and resources, if used beyond that point real incomes and the welfare of low income groups would be at risk. Moreover, it could lead to instability of a kind strong enough to destroy full employment.

The views of the Treasury's GFEP Section on the correct principles of financial policy were set out by Frederick Wheeler in 1945:

(a) the level of total Government expenditure, including capital expenditure, should be such as will, with the related level of private expenditure, fully employ the community's resources of manpower and equipment.

(b) the composition of the appropriate level of government expenditure should be determined in conformity with the conventional Treasury standards of economy, utility, etc.

(c) the necessary finance should be obtained from taxation, public borrowing and central bank credit, in proportions determined in the light of conditions at the time.

(d) subject to any special variations necessary for employment reasons and to the normal considerations of incentive, equity, ability to pay, etc., the proportion of total expenditure financed from taxation should be as high as possible and not lower than necessary to cover current services, e.g. interest, social services, administration, etc.

Such a taxation policy has the advantage of keeping the debt and interest burden to a minimum which is an advantage even when the objects of expenditure are 'reproductive works'. With the safeguards mentioned it would not cripple the taxpayer or
prevent any legitimate use of central bank credit.\textsuperscript{17} As with the Full Employment White Paper, which adopted these principles, the references to central bank finance and public borrowing make it clear that the use of budget deficits to ensure the full employment of real resources was taken for granted.

Some idea of the Treasury's approach to budgetary policy immediately after the war is provided in a paper entitled Taxation and the Economy, which Chifley presented to Parliament on the occasion of the 1948-49 budget. The Institute of Public Affairs dismissed it as being 'in some ways a curiously unscientific document'.\textsuperscript{18} Fadden claimed that the paper 'was compiled by and on behalf of the Treasury in order to endeavour to justify the Treasurer's taxation policy', and continued: 'The purpose of the authors was to resist or to prove the wisdom of resisting reductions of tax.'\textsuperscript{19} The document was indeed mostly concerned with explaining why the government 'could not have reduced taxation at will'. A number of arguments were raised. First, and here the argument was essentially accounting in nature, the government had to meet 'immense and inescapable' war and post-war expenditures. Increased borrowing from the public to meet these expenditures was out of the question: by June 1946 public borrowings for war were already in excess of $2,000 million. Increased borrowing from the Commonwealth Bank was also dismissed. It was argued that such

\textsuperscript{17} Quoted in Selwyn Cornish, 'Full Employment in Australia: The Genesis of a White Paper'. Paper presented to the Post-War Reconstruction Seminar, Canberra, August-September 1981, p. 172; emphasis in the original.


\textsuperscript{19} CPD, Vol. 201, 22 February 1949, p. 534.
borrowings entailed an extreme danger of inflation. Similar arguments, as
noted, were advanced in the Full Employment White Paper. Future
Commonwealth expenditure was to be at least five times the level of pre-war
expenditure. Moreover, most of this was inescapable expenditure. Thus for
revenue to meet these commitments it was impossible for there to be a
'wholesale cutting' of taxes.

The second reason why the government had resisted large-scale tax
reductions was that financial policy had been directed at countering the
inflation 'inevitably' resulting from the war: 'Tax reduction increase the
amount people can spend or try to spend. When goods are scarce, as they
have been, this will tend to force prices up and the Government could not
ignore this fact. It is pledged to maintain full employment and economic
stability. Tax cuts were justifiable therefore only as and when the
general situation improved.' The It was claimed that graduated direct
taxation, together with a number of other devices had checked inflation.

The Treasury rejected the argument that taxation, by discouraging
effort and enterprise, had limited the supply of goods and thereby
contributed to demand inflation. The contrary was in fact the case: 'The
Government has refused to make tax reductions where these would have
increased the gap between purchasing power and supplies. The growth of
industry, the rise in employment, and the all-round increase of output have
profited by the economic stability thereby ensured'. Nor could it be
argued that taxation was deflationary in that the burden of taxation was so

20 Taxation and the Economy, (Commonwealth Government Printer, Canberra,
1948), p. 4.
21 Ibid., p. 7.
heavy that demand, profits and enterprise had been dampened:

Central facts are that while tax collections in 1947-48 were £33,000,000 higher than the previous year, national income, the source of demand, was £276,000,000 higher. This made a potential addition to demand of £243,000,000 - which hardly looks like deflation. Nor are large surpluses being tucked away in Government accounts. The Budget was balanced last year. Proper provision was also made as required under legislation for social service payments and similar expenditures. These, however, were no more than wise precautions taken in a year when incomes were high against times when revenue may be far more difficult to obtain.22

Here was the essence of the Treasury's approach to budgetary policy in the immediate post-war years. Though adopting the Keynesian line that taxation had been used as an anti-inflationary device, as a means of closing the gap between purchasing power and aggregate supply, the Treasury remained imbued with an apologetic balanced budget approach which sought to portray the government's actions as largely neutral. This perhaps was not surprising given the political pressure to reduce taxation, the public's lack of economic education and, more particularly, the fact that the Treasury was still headed by stalwarts of financial orthodoxy such as McFarlane and Watt. Moreover, it was perhaps only to be expected that the traditional role of financial controller should have had a dominating influence, at least initially, on the department's approach to economic issues. The traditional and the new interacted and moulded each other.

Whatever changes may have occurred in the Treasury's views on the role of the budget, its approach to monetary policy was notably inflexible even into the early 1950s. The Treasury's traditional concern with keeping costs to a minimum deemed it essential that interest rates should be kept

22 Ibid.
low. An increase in interest rates necessarily meant an increase in the public debt and in the cost of borrowing and thus, using purely financial criteria, was judged undesirable.

As will be seen in the next section, the Treasury's unwillingness to vary interest rates and its confused admixture of Keynesian and balanced budget ideas were reflected in the Chifley Government's approach to economic management.

Economic Management under the Chifley Government

Economists - no less than other people - do not like discarding an apparatus of thought that they have built up slowly and laboriously. Moreover, habits are formed and are difficult to shake off. People who have become accustomed to certain conclusions from a given set of facts find it difficult - as circumstances change - to come to different conclusions from what seem to be the same facts. Economic theory has not yet been fully adjusted to the new concepts which Keynes has given us. Meanwhile time marches on... It is, however, not only economists and economic theory that lag behind a changing world. Statesmen and practical men of affairs usually have a social philosophy which they absorbed in their formative years. They will often be found, therefore, trying to apply to current events a theory which is no longer suitable.

- L.G. Melville, 1946

The task facing the Chifley Government was the difficult one of transition from war to peace. The key problem was one of dealing with a level of aggregate demand far in excess of available supplies. Its ability to deal with this problem was constrained by the fact that it was committed to a programme of heavy industrial investment and expansion and to a wide range

of social service benefits. There was the additional difficulty of restricted access to imports as a result of the dollar scarcity problem. Moreover, the government was faced with an electorate tired of a plethora of restrictions and regulations, anxious to shed the onerous yoke of taxation imposed during the war, impatient with shortages of basic goods and services, and insistent on higher pay and shorter working hours.

In dealing with the problem of excess demand, the Labor government's preference was for the use of direct regulatory measures. The lesson provided by World War I was that direct controls should not be abandoned hastily following the cessation of hostilities, while the lesson from World War II, at least for Labor, was that direct controls were an indispensable supplement to purely financial (indirect) measures. In his 1944-45 budget speech Chifley voiced his concern at what seemed to him to be 'a very dangerous tendency to assume that with the increasingly favorable turn of the war, these controls [price control, rationing and control of supplies] are less necessary and can be lightened'. He declared: 'There could not be a more dangerous state of mind or one more fatal to the stability of our economy.' \[24\] In the Full Employment White Paper and in the 1945-46 budget, direct controls were singled out as being crucial to a stable transition from war to peace. In the White Paper it was argued that even after the transition period certain situations might make it 'necessary for governments to exercise some degree of direct control in order to avoid inflation'. \[25\] The problem for the Labor

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government, however, was that the power to control directly wages, prices, and capital issues was restricted to the jurisdiction of State governments. Twice in referenda, in 1944 and 1948, Labor attempted to have price and rent control incorporated in the Constitution as a Commonwealth power. It was defeated on both occasions. Labor's predilection for direct controls was again made clear in October 1950 when, now in opposition, it advocated a referendum to transfer price control (but not control over rents and charges) to the Commonwealth. Senator McKenna, who led the Opposition's case, declared:

I tell the Minister now, speaking on behalf of the Labor party, that, no matter what measures are proposed in the budget, they are doomed to failure if they are not to be buttressed by some form of efficient price control, at a national level and not hampered by the limitations of State powers between the Commonwealth and the States.26

Even in 1956 Arndt could complain:

In a period when Australia's number one economic problem has been inflation, Labor, inhibited by traditional fears for the maintenance of full employment, has done little more than advocate direct controls which it knew to be impracticable without prior constitutional reform and make political capital out of the unpopularity of other measures to deal with the situation.27

Following a series of High Court rulings on the use of the Commonwealth's defence powers and with the failure of the 1948 referendum, the Commonwealth's power to implement direct controls, with the exception of import controls, terminated. Ways therefore had to be found for managing the economy, in particular controlling the double-digit inflation which began to be experienced from 1948 onwards, by the use of indirect

Assessing the budgetary policies of the Labor government is a difficult task. A notable feature of the period was the absence of any clear-cut, let alone detailed, budgetary principles. Chifley was content to make statements such as the following:

"security, in the largest sense, has all along been the key-note of the Government's financial and economic programme. We have aimed to reduce taxation and have done so, but not at any stage before financial conditions warranted the step. We have aimed to lift standards of social benefits and have done so, but, again, no measure has been adopted before the resources were in sight." 28

the Government has consistently refused to embark upon financial measures that were not clearly practicable and for which the resources were not in sight. 29

The difficulty with such statements is that they are open to a variety of interpretations. On the one hand it could be argued that one of Chifley's main concerns was to weigh tax cuts against the resources available to the government. In the political circumstances of the time, this may have been intended to suggest a balanced budget approach had been adopted: budgetary changes would only be made when the resources were available to do so. On the other hand a Keynesian interpretation is possible if the Prime Minister's statements are taken to mean that changes were made only when supply had improved to such an extent that to unleash extra demand pressures would not prejudice the balance between these two forces.

On a number of occasions Chifley openly proclaimed budget balance to be an important desideratum. When, in September 1948, he was able to

announce that for the first time since 1939-40 a small surplus had been achieved, he declared proudly: 'I think it is a matter for deep gratification that in the three years after the war ended it was possible to achieve this result. It meant that the huge wartime gap between revenue and expenditure had been eliminated and that budget equilibrium, a prime condition of financial and economic stability in these times, had been attained.'

The following year, 1949, the Prime Minister could again announce that balance had been achieved. Over the previous two financial years it had been unnecessary to borrow for current purposes: the essential requirement of balanced budgets had been achieved. In addition, 'substantial sums' had been set aside in the National Welfare Fund and the War Gratuity Reserve. In a financial statement presented in February 1949 the Prime Minister declared:

[The Government] has eliminated the huge gap between revenue and expenditure and has built up reserves, such as the National Welfare Fund and the War Gratuity Reserve, against future expenditures. Present conditions are such that this policy should be followed even more firmly than during the past three years. We face a greater need than ever to conserve the resources presently available to the Government. Revenue ought, as far as possible, to cover all forms of expenditure, including provision for definite commitments still to be met.

Similarly, discussing government business undertakings, Chifley argued that: 'It is, I believe, a sound principle that, under conditions such as the present, the revenue of undertakings derived from charges for services to the public should, as far as practicable, suffice to cover their expenditure.'

32 Ibid., p. 242.
Again, it is true that the statements above do not necessarily contravene Keynesian principles. But given the prevailing conditions of excess demand, the Keynesian would argue that revenue should not only cover expenditure but should considerably exceed it. Chifley's statements appeared deliberately designed to give the impression of a balanced budget approach.

The nominal budget figures for 1945-49 do not clarify matters. Although in each of the post-war years Chifley budgeted for a nominal deficit, from 1945-46 to 1948-49 he budgeted for successively smaller deficits. This was quite in keeping with Keynesian principles. However, the Prime Minister's actions could also be interpreted as evidence of a determination to achieve fiscal balance. In fact, in 1947-48 and 1948-49 balance was actually achieved. But in the 1949-50 budget, despite an announcement that he expected inflation to continue, Chifley budgeted for a nominal deficit which was twice as large as the estimated deficit for 1948-49.

In determining the expansionary or contractionary nature of a budget, however, one must look not just at the relative size of the deficit or surplus but at the absolute changes in overall government expenditure. The point behind the balanced budget multiplier is that, even if a budget is balanced, an absolute increase in government expenditure will be employment- and income-creating and hence will add to aggregate demand. From 1945-46 to 1947-48 Chifley budgeted for consecutive

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33 One must also look of course at a range of other factors such as the tax structure and, in the case of deficits, the financing arrangements.
decreases in estimated expenditure. However, just at the time when inflation took hold from 1947-48 onwards and as direct controls were phased out, he budgeted for increases in expenditure. In fact, actual expenditure began to increase earlier, from 1947-48 onwards. Actual expenditure rose from $912 million in 1947-48 to $535 million in 1948-49 and to $1,184 million in 1949-50. The most notable increases were in expenditure on capital works and services which rose in nominal terms by 80 per cent in 1947-48, by 41 per cent in 1948-49 and by 140 per cent in 1949-50. Although it may be possible to justify this capital expenditure on non-Keynesian criteria, there can be no doubt that the actions of the Labor government contributed significantly to demand pressures.

Nevertheless, it does appear that Chifley made some attempt to use the budget as a deflationary device. Some writers have argued that the fact that the government was able to reduce its short-term debt through the redemption of Commonwealth Treasury Bills indicates that, at least in 1946-47 and 1947-48, budget surpluses had been obtained.34 Also of relevance here is the Labor government's use of the Trust Fund account to obfuscate its true budgetary position. By virtue of Section 5 (a) of the Surplus Revenue Act 1908, the Commonwealth government can credit certain sums of expenditure to trust funds for subsequent use. These transfers, however, were often listed as current expenditure for a particular year even though they were not actually spent in that year. It seems that via the use of the Trust Fund, particularly the National Welfare Fund which began

operating at the beginning of July 1943, the Labor government managed to syphon some excess liquidity out of the system. Coombs argued in 1948 that during the transition from war to peace the government had 'contemplated that the Budget would be deflationary in its effect. The institution of the Social Security Fund [National Welfare Fund] was designed to ensure that during periods of high employment substantial reserves would be built up - in effect, the Budget would provide for a substantial surplus.' As noted, Chifley claimed in 1949 that 'substantial sums' had been put aside in the National Welfare Fund and the War Gratuity Reserve. The balance in the National Welfare Fund, which at the end June 1946 stood at $100 million, was in excess of $260 million at the same date in 1950. This suggests that it made some, though certainly an inadequate, contribution to reducing inflationary pressures.

35 H.C. Coombs, 'Australia's Ability to Avoid Booms and Depressions', Economic Papers, No. 8, 1948, p. 44. However, Coombs was convinced that the budget had failed in this regard.

36 It is testimony to the confusions and the inconsistencies of this period that in the official publication, Taxation and the Economy, published in 1948, the contrary claim was made. It was argued that: 'Nor are large surpluses being tucked away in Government accounts.'

37 As Mauldon argued in his Presidential address to Section G of the 1949 ANZAAS conference: 'during the transition, the Governments, in employing these resources, have mediated the use of money claims upon goods and services, while doing little or nothing to contract the volume of such claims - a volume which continued to expand always somewhat more rapidly than the flow of goods and services themselves. It is true that some of the revenue was "tucked away" in special accounts for social service payments and similar expenditures, but such freezing - if it was "freezing" - was far from adequate.' F.R.E. Mauldon, 'The Consumer in a Planned Economy', Economic Record, Vol. 25, June 1949, p. 13.
A final relevant consideration relates to the fact that accounting conventions deemed that the only expenditure which should be charged to the Consolidated Revenue Fund was current expenditure while capital expenditure should only be charged to the Loan Fund. This convention was important because the budgetary position, as described in the annual budget speeches, referred to the difference between expenditure from, and revenue paid into, the Consolidated Revenue Fund. One way in which the Commonwealth government could disguise its true budgetary position was by breaking this convention and charging capital expenditure to Consolidated Revenue. This in fact became established Treasury practice during World War II and Chifley continued the practice into the post-war period. In his 1948-49 budget speech the Prime Minister announced that the estimated gap between revenue and expenditure was $36 million and that this would have to be paid for from the Loan Fund. The Sydney Morning Herald, however, took a different view, arguing that some $76 million of capital expenditure had been charged to Consolidated Revenue, instead of Loan, and that had 'normal methods of accounting' been employed the Prime Minister would have had to confess to a prospective surplus of approximately $50 million. Similar arguments were advanced in 1949: the Herald argued that normal accounting standards had been violated and that the announced deficit was in fact a 'heavy surplus'. Other assessments, however, cloud such an assessment, especially when the 1949-50 budget is taken into account. Donald Cochrane argued that a more accurate picture of the true budgetary position for 1949-50 would arise by adding to the official statistics expenditure from

38 Sydney Morning Herald, 9 September 1948.
39 Ibid., 8 September 1949.
the Loan Fund and the War Gratuity Reserve and deducting the appropriations made to the sinking fund and the increase in the National Welfare Fund. This procedure left the actual deficit for 1949-50 at $14.8 million.\textsuperscript{40} Despite this re-evaluation, the conclusion nevertheless remains that the 1949-50 budget, given the prevailing conditions, was decidedly non-Keynesian. D.A.L. Auld's detailed analysis of post-war fiscal policy confirms this. Auld's assessment is that the 1949-50 budget was clearly inflationary and severely destabilising.\textsuperscript{41}

In summary, Chifley (and subsequently Fadden) used a number of devices which make it difficult to evaluate the net quantitative effect of the government's budgetary policies. Such devices, in turn, make it difficult to judge whether Labor's budgetary policy flowed primarily from balanced budget or Keynesian principles. As one contemporary observer concluded: 'The obscurity of the Government's accounts and the reticences of the Treasury and Central Bank alike are responsible for much of the confusion and public comment on economic policy.'\textsuperscript{42} What is clear is that Labor's preference was for direct regulatory measures to deal with inflation and that if it did attempt Keynesian policies it was heavily disguised Keynesianism or Keynesianism by stealth.

\textsuperscript{40} Donald Cochrane, 'Federal Budget is Analysed', \textit{Argus}, Financial and Commercial Supplement, 26 October 1950, p. 25.


\textsuperscript{42} R.J. Wood, 'Budget Details Are Often Obscure', \textit{Australian Financial Review}, 11 October 1951.

221.
The imbalance between supply and demand which had been steadily worsening in the last few years of the Chifley Government, and which was manifested in an increasing inflation rate, was to become acute in 1950 and 1951 - the years of the Korean War boom. The main impetus to the boom was provided by a remarkably rapid rise in wool prices in the 1950-51 selling season which led in turn to what Fadden referred to as a 'great flood' of export income. Demand pressures were compounded by the Conciliation and Arbitration Commission's policy of automatic cost-of-living adjustments. The size of the boom can be gauged by the following figures. In the 1950-51 financial year national income in current prices rose by 35 per cent, farm incomes by 65 per cent, and wages and salaries income by 26 per cent. Over the same time period the 'C' series index of retail prices rose by 19 per cent, the wholesale price index by 24 per cent and average wages by 26 per cent.\(^43\)

The Menzies-Fadden government refrained from taking effective action to control the boom until September 1951 by which time its apogee had passed. The fact that the 1951 budget was belated and served merely to hasten the downswing has drawn attention away from the important fact that the budget represented the first explicit use of fiscal policy for anti-cyclical purposes, that the 1951 budget was Keynesian in practice, principle and spirit and openly so. The budget was an exercise in economic control. It was predicated on a belief that the government could and

\(^{43}\) Financial Statement by A.W. Fadden, CPD, Vol. 217, 6 May 1952, p. 34.
should regulate the level of economic activity in an attempt to keep the economy to as an even a course as possible. It was surely not mere coincidence that Roland Wilson had been appointed Secretary to the Treasury shortly before the budget.

Public reaction to the budget took the form of dismay and bewilderment. It was nicknamed the Horror Budget. The *Australian Financial Review* argued that the only people who seemed to be in agreement with the government's fiscal initiatives were academic economists. The *Sydney Morning Herald* initially blamed Copland for being the guiding force behind the government's invidious economic strategy. Others blamed Coombs. Roland Wilson eventually came to be labelled the villain of the piece.

Fadden began his budget speech by explaining the inflationary process and did so employing Keynesian gap analysis:

The essential nature of inflation lies in a disproportion between money demand for goods and productive resources on the one hand and the supply of goods and resources on the other. This disparity began in Australia when the late war began and, though masked for a period by controls, it has been growing ever since.... The post-war situation has at all times been an unstable one. The money demand for goods has continually risen in advance of the available supply of goods, both local and imported.44

The cause suggested the cure: it was necessary to 'close the gap' between the demand for goods and services and the supply. The Treasurer was confident that 'a great deal' could be done to restrain both consumption and investment expenditure. He pointed out that 'powerful measures' had already been undertaken to achieve this end via control of the volume of

credit and control of capital issues. But he insisted that budgetary policy was of key importance in regulating economic activity and he outlined, in straightforwardly Keynesian terms, the principles which he believed such policy should follow:

The Government believes firmly that under the present highly inflationary conditions total receipts should do more than cover total expenditure - they should be sufficient also to provide a substantial surplus. Modern thought on the relation of public finance to economic stability is quite clear on the point that in times of depressed trade and unemployment, governments may justifiably run into deficit and even finance some part of their needs with central bank credit, so raising the level of community spending power. It is a vital corollary of this view, however, that, in times of excessive demand and scarcity of labour, governments should draw away from the public in taxation and loans more than they spend for current purposes... If ever there was such a situation which called for such a measure, it is surely the situation we now face in Australia.45

It could be argued that in many ways the 1951 budget strategy was forced onto the government, given that during its years in opposition it had denounced Labor for supposed socialist tendencies and had argued vehemently against any form of direct controls in the 1944 and 1948 referenda campaigns and in the 1949 election campaign. With an inflation rate of over 20 per cent it seemed essential to bring the situation under control; financial policy was the only available means to do so without appearing hypocritical. Nevertheless, the actions of the Menzies Government in subsequent years revealed that the need to use Keynesian stabilisation techniques had been fully accepted. For example, faced in 1952 with a recession (resulting essentially from the collapse of export prices in 1951 and the depressive effects of a rapid and strong rise in imports and intensified by the Horror Budget) it was decided in the August

45 Ibid., p. 54.
budget to drop the 10 per cent levy on income tax and social service contributions imposed in 1951 and to reduce company taxation. Fadden explained that policies were merely means to an end and that they should therefore be revised according to changing conditions. Policies needed to be discretionary, flexible. As he declared in May in a financial statement: 'Less perhaps in these times than ever before can we afford to be dogmatic about the future course of economic affairs. The outlook is too obscure, and events are too changeable.' 46 Thus banking policy 'is not being applied rigidly or unrealistically. It is being modified according to changing requirements and circumstances.' 47

Events were soon to prove, however, that political considerations limited the extent to which policies were adapted in the face of changing economic trends. By 1954 it was evident that the pace of activity was quickening and that the economy was heading toward boom conditions. During 1954-55 total employment achieved record levels, output rose strongly and consumption expenditure increased by 9 per cent on the previous year. In 1955 excess demand spilled over into imports and the level of Australia's international reserves began to fall rapidly. The balance of payments on current account in 1954-55 was a deficit of $284 million. The need for deflationary policies became obvious. But 1955 was an election year and the government postponed any effective action until early in 1956. It resorted instead to moral suasion, stressing the need for community restraint in its spending habits and initiating conferences with banks and other financial institutions to consider a possible tightening in their

46 Financial Statement by Fadden, 6 May 1952, p. 45.
47 Ibid., p. 42.
credit policies. In September 1955 Menzies announced that import restrictions would be intensified and declared that the government had decided that equilibrium in the external payments situation be restored by 30 June 1956. By March 1956, with the election safely behind it, the government decided that supplementary measures were necessary. Explaining the rationale for this, Menzies declared:

prosperity needs to be understood if it is to be preserved. Like so many other good things, it tends to generate forces which may turn out to be adverse to it.... It should continually be emphasized that we are neither anticipating nor seeking to meet a depression, still less to make one. What we are trying to do is to prevent some elements in our prosperity from aggravating an inflation which could, if left alone, undermine our prosperity. That is why I say that all the adverse factors are manageable, provided that we are prepared to prefer a lasting prosperity to a temporary boom which, if uncontrolled, could lead to unhappy consequences.48

The message was that prosperity contained the seeds of its own unmaking, that it could not be left alone, and that it had to be controlled. Accordingly, it was announced that public sector expenditure would be cut, company taxes increased, sales tax on cars raised from 16.6 per cent to 30 per cent and on commercial vehicles and motor cycles from 12.5 per cent to 16.6 per cent, and additional taxes levied on beer, spirits, tobacco, cigarettes and cigars.

A point made in the government's policy statements in 1955 and 1956 (and also in 1951 and 1952) was that it was becoming increasingly clear that the internal situation was the primary source of Australia's economic difficulties. As Fadden declared in the 1955-56 budget speech:

In the very broadest terms we confront to-day, in yet another

of its ever-varying forms, the problem of preserving stability in our economy. It is the economy of a young country, vast and rich but highly changeful, dependent to an extreme degree upon world trends which affect its trade, but influenced at least as much, and perhaps increasingly, by internal forces generated in the effort to build up its population, its defences and its industries at an urgent pace. Sometimes it is instability abroad that shakes our own stability. It is not so much that factor now, though it is not entirely absent. Our difficulties to-day are preponderantly of local origin and that is a vitally important fact.49

The fact that instability was being generated primarily from domestic sources meant that control was more efficacious. No longer could it be claimed that fluctuations in export income were the fundamental cause of Australia's instability and that therefore there was little that could be done to promote stability. 'We have ... learnt that we can achieve and maintain stability if we are determined to do so.'50

Conclusion

The Keynesian model which had been accepted in theory by the end of World War II had been accepted in practice also by the early 1950s. The government, and its Treasury advisers, were convinced that conscious, purposive action was possible and necessary, given the economy's inability to regulate itself. The key instrument of control was the annual budget. Furthermore, it was accepted that control should be exercised with a degree of flexibility, given the capriciousness which was characteristic of the economy. In the case of the fiscal policy, it was necessary to budget for surpluses or deficits according to the circumstances. Such policies were

50 Ibid.
purposive. The aim was to steer a course between inflation and unemployment, between boom and slump. Keynes's message that this was possible had been accepted and implemented and the results seemed promising. In 1953 the Treasurer could announce:

It used to be axiomatic that every boom had to be followed by a slump and, usually, the worse the boom the worse the slump. Yet the recent boom, one of the sharpest in our history, was brought under control without incurring anything that, by any stretch of the imagination, could be called a slump. That, I venture to claim, was a quite unprecedented achievement. 51

A notable feature of post-war economic thought in Australia was that Keynesianism became so quickly and widely accepted. The Australian experiences provide an interesting contrast with countries such as Great Britain, the United States and West Germany. During Adenauer's Chancellorship the emphasis in West German budgetary policy was on orderly housekeeping. Schonfield points out that:

The German authorities behaved as if the revolution in economic thinking which derived from the work of Keynes in the 1930s had never occurred at all. It is indeed remarkable how few people in Germany, even among the professional economists, had taken in this great intellectual change, before the second half of the 1950s. It took even longer to penetrate the embattled outworks of the Ministry of Finance. 52

It was not until the early 1960s that the acceptance and adoption of Keynesian fiscal ideas became apparent in Germany. 53 Similarly, it has been argued with respect to post-war economic policy in the United States that Kennedy was the first Keynesian President and that the permanent tax

53 See ibid., pp. 273-89.
cut approved by Congress in 1964 (at a time when the budget was already unbalanced) was the first occasion in which the notion of deliberately using fiscal measures for stimulatory purposes gained widespread acceptance and understanding.\(^{54}\) Winch points out that the heated Congressional debates over the New Deal strategy and over the 1946 Employment Act provided a portent of the obstacles which were later to be encountered in attempts to secure an acceptance of Keynesian fiscal ideas in the United States.\(^{55}\) He notes that during Eisenhower's administration "Keynesianism" was still regarded by many Republicans as a Democratic Party doctrine, irrevocably associated with the New Deal.\(^{56}\) It was perhaps not surprising therefore that Eisenhower chose Arthur Burns as Chairman of the Council of Economic Advisers, a man whom Winch describes as 'non-Keynesian, if not actually anti-Keynesian'.\(^{57}\) In Great Britain the ideas of the first post-war Labor government provide an interesting contrast with its Australian counterpart in that both preferred the use of direct controls and only reluctantly and slowly accepted the use of financial levers as a method of economic control. There is a similarity also between the two countries in that it was Conservative governments which first explicitly used the budget in a purposive way - in Great Britain this was in 1953 when budgetary action was taken with the aim of deliberately stimulating the economy. The budgetary actions of 1953, however, did not mark the fruition of the Keynesian revolution in Great Britain. For during the 1950s elements of


\(^{55}\) Ibid., p. 305.

\(^{56}\) Ibid., p. 310.

\(^{57}\) Ibid., p. 311.
pre-Keynesian thinking were to re-emerge in the approach of the Conservatives to economic management - in particular a heavy reliance on maintaining stability by exercising a strict control over the money supply, an over-optimistic faith in the efficacy of such policy, and a marked enthusiasm for its non-discretionary and automatic character. Another interesting change was the elevation of price stability over full employment as the chief policy aim.\textsuperscript{58} It will be seen in the next chapter that despite whole-hearted support for Keynesian policy ideas, a number of pre-Keynesian notions were also to re-emerge by the end of the 1950s within the Australian Treasury.

\textsuperscript{58} Ibid., pp. 299-305.
Part Three

The Evolution of Australian Treasury Thought, 1956-79
Introduction to Part Three

Part Three traces the evolution of Treasury thought from 1956 to 1979. It seeks to show the department's steadily increasing acceptance of the neoclassical model and to canvass some of the reasons for the change in the department's outlook. It comprises five chapters arranged, with the exception of the final chapter, chronologically.

Chapter Six discusses the period 1956-62 and argues that even by the end of the 1950s it was evident that the Treasury had moved from the Keynesian approach of the F & E Committee toward a form of bastard Keynesianism. An emphasis on the need for increased savings was indicative of a shift toward the supply side. It is interesting also that a tendency had arisen to abstract from the importance of cyclical change and to focus instead on the economy's capacity for continuous growth and on the persistent tendency toward excessive pressure on resources. Chapter Seven, which covers the years 1963-67, a period notable for steadiness and stability, traces the department's growing concern with efficient resource allocation and the related concepts of choice, maximisation and economic scarcity. It considers also the department's belief that the economy was becoming ever stronger and better able to look after itself. The Treasury's reaction to the internal and external instability arising in 1968-73 in the form of inflation and then stagflation, intense stock market speculation, mounting industrial unrest, and the collapse of the Bretton Woods system, is analysed in Chapter Eight. It is argued that in the face of apparent disorder the neat and deterministic analysis of neoclassical economics became increasingly more attractive. It is argued also that after more than a decade of steadily-mounting scepticism of the notion of
human malleability, Keynesian meliorism was at last abandoned and replaced by a credo stressing the need for market-induced discipline. Chapter Nine takes the discussion up to 1979 and shows that by the mid-1970s the department's model was close to fully-fledged neoclassicism. In Chapter Ten the reasons why there has been a transition in Treasury thought are discussed.
Chapter Six: **Savings and Balanced Growth: 1956-62**

The relationship of saving to consumption must have a crucial importance for a growing country like Australia. Such crude indicators as we have suggest that the level of saving in Australia may not be unduly low by comparison with that of other countries but it is still inadequate for our needs and it fluctuates widely from period to period.

- 1957 and Beyond: An Economic Survey

This chapter discusses the first seven economic surveys, those published between 1956 and 1962. It seeks to show that by the end of the 1950s a distinct change had occurred in Treasury thought which took three main forms: a move toward the supply side evidenced by an insistence that an adequate and stable level of savings be maintained and by a belief that savings determined investment; a growing scepticism of the malleability of human nature and of the possibility of achieving social consensus; and a tendency to abstract from the economy's cyclical changes by emphasising instead the inevitability of continuous economic growth and the persistence of excess pressure on resources.

The chapter does not dwell on demonstrating the Treasury's acceptance of Keynesian ideas. Throughout 1956-62 there were repeated references in the surveys to familiar Keynesian concepts such as the importance of aggregate demand in determining output and employment levels and the imperative need to regulate to keep the economy on an even keel. It would be repetitive to demonstrate the pervasiveness of these ideas in

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the Treasury's outlook. What seems more interesting and more important is to identify, trace, and explain the genesis of the neoclassical model which was to dominate by the end of the 1970s.

The Problems of Continuous Growth: 1956-58

This section continues the analysis in Chapter Five and outlines economic conditions and policies in 1956-58. By a study of the relevant surveys, it seeks to show the interaction between changing economic conditions and the Treasury's evolving outlook.

It seems useful first, however, to consider some of the changes which occurred in the 1950s in the Treasury's personnel responsible for economic policy advice. In addition to the Secretary, Roland Wilson, the key economic policy advisers in the department were Richard Randall, Maurice O'Donnell, Frank Pryor and Robert Whitelaw.

Randall was born in 1906 at Birkdale, near Brisbane. After only two years at Wynnum High School he entered Brisbane Technical College and studies woolclassing. By the age of eighteen he was woolsorting in Western Queensland and continued to do so for eight years. In 1932 he matriculated while working part-time in wool stores to support his private study. This achieved, Randall took a correspondence course in accountancy. He then enrolled in the Economics Department at the University of Sydney, headed by

Professor R.C. Mills. When Randall graduated in 1936 he joined an 'elite' who had managed to obtain first class honours under Mills. This elite included J.G. Crawford, T.W. Swan, L.G. Melville, S.J. Butlin, R.B Madgwick, H.D. Black and S.H. Wolstenholme and it is interesting that a characteristic of Mills's elite, demonstrated clearly during World War II, was an early and ready acceptance of Keynesianism. In 1937 Randall was appointed Carnegie Research Scholar at the University of Sydney. He then joined the Premier's Office in Sydney as research officer, working as part of Sir Bertram Stevans's 'think tank'. In 1940 he moved to Canberra to join the Treasury. The following year, however, he enlisted in the AIF and spent most of the war in Western Australia. Randall did not resume his climb up the Treasury's ranks until 1946. In 1952 he was placed in charge of GFEP, succeeding Frederick Wheeler who had joined the International Labor Office as treasurer. In 1957 Randall was promoted to Deputy Secretary, a post he held until 1966.3

O'Donnell was born in 1907, the year after Randall. He attended Christian Brothers High School at Lewisham. In 1924 he joined the New South Wales Government Railways as a clerk in the stores branch. He remained at the railways for seventeen years. During World War II he joined the influx of temporary recruits enlisted by the Commonwealth Public Service to help cope with the administrative strains imposed by the war. Upon joining the service, O'Donnell was placed in charge of the supply and shipping accounts section of the Ministry of Munitions, located in

3 Most of this biographical material on Randall comes from Ian Fitchett, 'From Woolsorter to Treasury Secretary', *Sydney Morning Herald*, 2 November 1966.
Sydney. This gave him a chance to complete a part-time degree in Economics at the University of Sydney. He graduated with honours in 1942. In 1946 he became a senior research officer in the Treasury and in 1951 was placed in charge of the Commonwealth Sub-Treasury, Sydney. From 1953 to 1955 O'Donnell was Assistant Secretary in GFEP and from 1955 to 1957 was Assistant Secretary in charge of the Defence Division, Melbourne. When Randall became Deputy Secretary in 1957, O'Donnell was placed in charge of GFEP and remained as such until 1965. 4

Pryor and Whitelaw, as noted in Chapter One, entered the Treasury during the war. Pryor joined in 1941 after completing an honours Arts degree at the University of Sydney. He was appointed Assistant Secretary in GFEP in 1955. Whitelaw graduated in Arts and Commerce from the University of Melbourne in 1942. From 1949 to 1952 he was Assistant Treasury Representative in London and during this time he completed a doctorate in international economics at the London School of Economics. 5

In September 1955 Whitelaw was promoted to Chief Finance Officer, Grade 1, his duties being to supervise and control the work of the Overseas Finance Section. In June 1957 he was promoted to Grade 2 and in the following year to Assistant Secretary.

It is likely that all of these officers were sympathetic with Keynesian ideas. Both Randall and O'Donnell were in their twenties when the depression reached its apogee; neither progressed straight from school

5 This was entitled 'The Sterling Area as a Changing Mechanism of Financing International Payments'.

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to university; both had been employment for several years before undertaking university degrees. Thus, both experienced the depression first-hand and at a particularly impressionable age. It seems reasonable to expect therefore that their views on the economy were dominated by the apparent persistence of instability and the problems, particularly the insecurity, caused by it and that the message of the General Theory would have been received favourably. Pryor and Whitelaw graduated at a time when Keynesian ideas were becoming more readily accepted. Moreover, their work in the GFEP Section during World War II brought them into direct contact with the views of the F & E Committee and with the debate over the Full Employment White Paper. The fact that Wilson adhered to a distinctly Keynesian outlook has been established already.

At the beginning of the 1960s two further appointments were made in GFEP. In 1960 Don Craik was appointed Assistant Secretary in charge of the Home Finance Division. In July 1961 Roy Daniel was appointed Assistant Secretary in charge of the Overseas Finance and Research and Information Divisions. Craik, an Economics graduate of the University of Sydney, had been on the staff of the Commonwealth Bank from 1933 to 1940, a time when the General Theory was avidly debated by members of the Bank's economic section, which included Coombs, Jock Phillips and the head of the section, L.G. Melville. In 1940 Craik joined the Taxation Branch of the Treasury and stayed there for twenty years until his GFEP appointment. Craik replaced Pryor who temporarily left the Treasury to become alternate director of the International Monetary Fund.

The interesting thing about Daniel is that his formative years were in the post-war period. His appointment in 1961 marked the beginning of a
significant age restructuring in the department's senior personnel which involved the increasing domination of the Treasury by officers whose outlooks were coloured by the notion of continuous growth and full employment. Daniel graduated from the University of Melbourne in 1949 with honours in Arts, majoring in economics. In September 1955 he was appointed Senior Finance Officer, Grade 2, in GFEP, his duties being to conduct and supervise research and investigation into the financial and economic policy aspects of trends in the Australian economy. In May 1956 he was promoted to Chief Finance Officer, Grade 1, and was placed in charge of the new Research and Information Section in GFEP. When he was appointed Assistant Secretary in 1961 he replaced Whitelaw who was appointed Treasury representative in London.

(a) Economic Conditions and Policies

Unlike the deflationary measures of 1951, those of March 1956 (described in the previous chapter) served their purpose but did so without producing a recession. Although there was a slight rise in unemployment and a slowdown in the pace of activity in some sectors, overall output levels were maintained in 1956-57, thereby extending a phase of prosperity which had continued uninterrupted since 1953. The 1956-57 budget speech, presented in August, pointed out that inflationary pressures had eased and that competition for resources was less intense but that an imbalance between aggregate supply and demand was persisting. Particularly unsatisfactory was the external situation, Australia's international reserves having fallen by $146 million in 1955-56. Another problem was the cumulative increases which had occurred in costs and prices (between 5 and 6 per cent
in 1956) and which were attributed partly to the automatic wage adjustment practised in some states and partly to the delayed effect of the rapid increase in spending experienced over the previous two years. But in the 1957-58 budget speech the Treasurer could announce that the economy had entered a situation of 'substantial balance, both internal and external, at a high level of trade and industrial activity'. The most notable improvement was in the balance of payments, evidenced by an increase in international reserves of $424 million in 1956-57. Export earnings achieved record levels, being some $10 million above the figure attained in 1950-51 at the height of the Korean War boom.

By early 1958, however, the continuation of relatively high but stable growth levels appeared threatened. The main danger was that, due to drought and overseas recession, rural production and export prices had fallen and this meant that export earnings and farm income would be significantly lower than in the previous year. The 1959 Survey pointed out that although by 1956-57 farm income represented less than 10 per cent of gross national product, and as such the effect of a large fall in farm income was 'little more than marginal', the multiplier effects could be considerable.

After some initial doubts, occasioned by above normal increases in the unemployment rate in January and February 1958, it became evident that the slump in the rural export sector would not lead to a more general business recession. In fact, in 1958-59 aggregate employment, building activity and industrial investment remained at high levels while industrial

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output increased and was matched by rising consumption demand; both private investment expenditure and total consumption expenditure grew by approximately 7 per cent; and the demand for motor vehicles was particularly strong. In the 1958-59 budget speech, Fadden's last, the economy was described as having made 'notable progress', despite the fact that total farm income was approximately one-third less than in 1956-57. The Treasury's judgement in May 1959 was that the economy had 'held together quite well'.

As the Treasury pointed out in 1959, the fact that a general recession did not occur in 1958 was due in part to a number of largely fortuitous factors. For example, Australia was fortunate that the drought of 1957 had been followed by a good season and that the rural slump was confined to the woollen industry. Several rural industries, such as wheat, barley, oats, meat and sugar, enjoyed a reasonably propitious year in 1958, thereby providing a psychological, as well as productive, boost to the rest of the economy. Australia was fortunate too, in part because of the import restrictions imposed in 1955-57, that businesses had not been laden with excess stocks during the rural slump - there had been no need to cut back production in order to liquidate stocks. The economy had been fortunate also that capital inflow had continued at high levels.

But in addition to the element of chance, a slump had been avoided because of the initiatives of both the private and public sectors. In the 1958-59 budget speech Fadden claimed that the main reason why the rural slump had not spread to other sectors was because of the government's 'timely and well-judged' fiscal and monetary measures which countered any depressive tendencies and stimulated expansionary forces. He cited the tax
concessions and increased public expenditure in the 1957-58 budget to bolster his argument and announced that the government would continue to support the economy by budgeting in 1958-59 for a nominal deficit of $220 million. Also of importance in the maintenance of relatively buoyant conditions was the fact, as Fadden put it, that 'the expansionary forces which have operated in this country during recent years have great strength and have imparted a high degree of resilience to our economy'. The Treasurer was convinced that the power of internal expansionary forces, together with the greater diversification of the economy, meant that it was now in a much better position to resist 'external shocks'.

(b) The Treasury and the Economy: 1956-58

This last-mentioned factor, the strength and persistence of the post-war expansionary drive, was of particular interest and importance to the Treasury. It was adamant that, as on previous occasions since 1945, a

Waterman, for one, agrees with the Treasurer's judgement, arguing that the general impression of the period January 1957 to August 1959 is one 'of skilful and intelligent use by government and central bank of a somewhat limited range of monetary and fiscal stabilization techniques'. He compares Australia favourably with the inept economic policies pursued in Canada from 1956 to 1959, and concludes: 'When it is remembered that the dependence of Australia upon a single staple was far greater than Canada's at this time, the performance of the Australian policy makers seems all the more impressive by contrast.' See A.M.C. Waterman, Economic Fluctuations in Australia, 1948 to 1964, (Australian National University Press, Canberra, 1972), pp. 145-6.


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positive attitude toward the future by the business community had acted in 1958 as an effective safeguard against the threat of general recession. While acknowledging the contribution of anti-cyclical policies, it argued in the 1959 Survey that the prime reason why a widespread slump had not occurred was because there had been 'a strong impetus to expansion in the economy and a fairly general determination in the business world to see the situation through'. Elsewhere in the survey the point was made that 'the spreading tendency [the drop in rural income] might have had was countered by the determination of other sectors in the economy to keep expanding'.

To the Treasury, the persistent strength of the expansionary drive and the continuity of growth to which it gave rise were the most remarkable features of the post-war period. As it argued in 1956, it seemed that since the war there had been 'an altered balance of forces':

there have been ... great differences in this period of rather more than a decade which mark it off from any earlier period and which suggest that new and powerful forces have been working in the economy, altering the nature of our economic problems, creating new problems and cancelling old ones. The instability we have experienced has been in some respects a different kind of instability (p. 12).

There had been booms but nothing that would have been called a slump by previous standards. There had been, and continued to be, tensions and pressures but they were all 'one-way'. The department claimed that such an occurrence defied nearly all previous experience: only in 'highly abnormal' periods such as the gold rushes and World Wars I and II (the long boom of 1861-90 was not considered) had there been comparable conditions of prolonged excessive pressure on resources. Thus, what was previously a self-evident and unquestioned rule about the course of economic activity - that economic activity took the form of bursts of progress followed invariably by prolonged periods of 'slackness and hesitation' - seemed
applicable no longer. One-way tension and pressure, having persisted for more than a decade, had now become 'almost the usual state of things'.

The 1956 Survey dwelt at length on the fact that the post-war growth process differed from pre-war experience in that it was 'deeper-seated, more determined and powerful'. The source of this new power was a desire to progress materially and to do so as quickly as possible. This power was such as to 'thrust aside obstacles and keep going in the face of events which, in other times, would have staggered the economy'. The aftermath of the Korean War boom provided a good example. At the end of the boom it seemed that Australia was in the midst of the 'classical conditions for a major industrial set-back'. In the event, some industries were affected detrimentally, but in the Treasury's view industry generally 'took the situation in its stride'. In a number of areas production increased 'almost as if nothing had happened'. Twelve months later the economy had returned to buoyant conditions. Such events provided the basis for the belief that in the post-war period there had been an altered balance of forces. They demonstrated that economic activity was not chained to an inexorable fluctuating pattern and suggested instead that economic development could follow a more or less linear path.

But while the acquisitive drive exhibited in the post-war period had the important positive attribute of lessening the likelihood of intractable deep recessions occurring - stagnation could not occur if the flow of activity kept up its momentum - it also had a number of negative ramifications. The Treasury was convinced that the desire to progress materially had led to an over-emphasis on consumption and an unfortunate neglect of the importance of savings. The central theme of the 1956 Survey
was that, both internally and externally, Australians had attempted to spend beyond their means. The result had been competition for domestic productive resources, particularly labour. And this competition, to extend the chain of causation, had led to production losses, works interruptions, and to a continuous increase in costs and prices. The persistent upward trend in costs and prices since the war and the large fall in international reserves in 1955-56 were taken to be a measure of Australia's profligacy.

Australians were seen as having an insatiable thirst for goods and services and as being financially reckless. The devil in Keynes's system, the ethic of thrift, had vanished from the scene: 'we are like a family which has been spending not only the whole of its earnings but also the money it has in the bank - spending it partly to enlarge its house and acquire other durable possessions but partly also to have a general good time'. The same point was made in 1957: 'A good many of us are prepared, if we can, to go beyond what we earn and borrow what other people have saved so that we may spend that too.' Financial prudence had been sacrificed to the twin gods of acquisition and having a 'general good time'. Australians had attempted 'to do too much too soon in too many directions'.

A point emphasised in the 1956 Survey was that demand pressures created problems when they were associated with an over-emphasis on the satisfaction of current needs to the neglect of future requirements. The argument advanced was that if a growing country was to increase its population and capital structure then 'a proportion of its efforts' had to be applied to meeting future requirements and not just present needs. The more rapidly a country attempted to expand the greater were these future

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requirements. This meant that current consumption would have to be cut back so that a proportion of income could be saved. Expansion for the future was held to be a common or societal objective; consumption in the present was an individual objective. The two objectives could be met simultaneously but, because most people found consumption more pleasurable than saving, the two probably would be in conflict. This conflict between individual and societal objectives, between current needs and future requirements, between consumption expenditure and savings, was seen as the fundamental conflict in a growing country. The continuous one-way tensions and pressures of the post-war period (and the inflationary and balance of payments problems with which they were manifested) highlighted this conflict.

The community's unwillingness to save had two main effects. First, it starved both the public and private sectors of adequate funds for capital works and production. Industries, lacking the capital to enlarge their future production capacity, would have to slow down or defer their plans. This could have harmful cumulative effects. Similarly, if public authorities had inadequate funds for works they would have to curtail their plans for expansion of future services. This would retard the provision of basic services and thereby retard progress in the private sector. Second, inadequate savings would lead to competition for the available funds. This would result almost certainly in high interest rates which in turn would lead to higher costs throughout the economy.

The rate of growth 'in all its aspects', the Treasury declared in the 1957 Survey, depended upon the level of output. However, output in turn depended largely on the adequacy of capital facilities and equipment.
which, again in turn, was a function of the available finances. The problem of financing expansion was therefore 'unquestionably the core of the whole problem of growth'.

Even in 1958, with economic balance having been maintained for eighteen months, the Treasury continued to press this point by devoting twenty-four pages to a discussion of the importance of having adequate funds to finance capital equipment and how these funds might be obtained. It argued that growth had as its aim population increase, full employment and rising living standards. To fulfil this aim output had to increase continuously. This, in turn, necessitated a steady enlargement of the capital structure: 'we have to build ahead of ourselves so that, as growth goes on, the basic services of the economy ... will meet the larger needs of the time'. The process of building ahead required that resources be diverted away from present toward future needs. This diversion had to be accomplished largely by financial means, by spending enough money to ensure the availability of resources for future requirements. Ideally, people and institutions should voluntarily provide sufficient savings from their incomes to meet the economy's necessary capital expenditure. If this be insufficient, local savings should in 'the ideal condition' be augmented by overseas capital. But the divergence was wide between this ideal and what in fact had happened in the post-war period and the Treasury concluded: 'on past experience, it would be a rare chance if, here or anywhere else, these ideal conditions were fulfilled'.

In brief, the lesson drawn from the experience of the post-war period was that it was essential that the growth process be a balanced one. As the department argued in 1958: 'We are likely to get more done
and to do it better if we recognize the need to work within the limitations of our resources.' What was required was not that each of the various elements on the supply side increase at the same rate as demand but that these elements, when combined, enable aggregate supply to keep in step with aggregate demand. Balanced growth necessitated recognising limits and not exceeding them. Working within these limits would not restrict growth; on the contrary, more would be done and in a more efficient manner. Growth had to be a controlled process. Higher growth rates were dependent on 'appropriate restraint' on total expenditure and a 'proper relationship' between consumption expenditure and savings.

As will be shown in the following section, the Treasury's call for restraint was to be ignored and its three prime desiderata - order, balance and stability - violated, leaving it convinced that Australians were indeed too acquisitive, too intent on satisfying their consumption wants, and that growth should occur within certain minimum and maximum limits.

Cyclical Instability: 1959-62

(a) Economic Conditions and Policies: 1959-62

After two years in which the economy seemed to be in balance, it became apparent in the second half of 1959 that the economy was heading toward

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boom conditions: there were strong increases in public authority, consumption, and particularly private capital expenditure; wool prices in the second half of 1959 were more than 10 per cent higher than those attained at the end of the 1958-59 selling season; demand for imports was rising; bank advances were exceeding usual growth rates; there was an upsurge in speculative activity in the stock market and in land sales; and shortages were occurring in the labour market - indicative of the tightening of the labour market was the fact that registered unfilled vacancies at the end of January 1960 were 11,500 higher than at the same time in the previous year. By the beginning of 1960 it was evident that aggregate expenditure was rising more rapidly than aggregate output - demand overall was exceeding supply - and this imbalance was reflected in the consumer price index which, having increased by 1.8 per cent in 1957 and 1.9 per cent in 1958, rose by 4.5 per cent in 1959.

Pushed along by the decision of the Conciliation and Arbitration Commission in June 1959 to raise the basic wage by 15s. a week, minimum weekly wage rates rose by 6.5 per cent in 1959, after having risen on average by about 1.5 per cent in both 1957 and 1958. Somewhat similarly, average weekly earnings rose on average by 3.5 per cent in both 1957 and 1958 and then increased by 5 per cent in 1959, the upward trend reflecting in part the decision of the Arbitration Commission in December 1959 to award an additional 21s. to the wage margins of metal trades workers.10

The inevitable result of the metal trades' decision and of the subsequent flow-on adjustment to other employee groups was an increase in

10 This represented a 28 per cent increase.
the pace of the boom during the first half of 1960. The decision had a
direct impact on personal consumption expenditure, which had already been
stimulated by the rise in the basic wage in June and by a 5 per cent
reduction in personal income tax in the August budget. In the eighteen
months to the end of the September quarter of 1960 consumption expenditure
increased by 17 per cent.

But it was not only consumption expenditure which increased
rapidly. Over the same period public authority expenditure rose by 13 per
cent and, most impressive of all, private capital expenditure jumped by 41
per cent. The rise in private capital was particularly pronounced in the
December quarter of 1959, when it increased at an average annual rate of 34
per cent.

Although the boom was particularly pronounced in the motor vehicles
and housing sectors, governmental action initially sought to impose
gradually increasing restraint to the economy as a whole. 11 Harold Holt,
Fadden's successor, a man who knew little about either economics or (unlike
Fadden) accounting and who in consequence relied heavily on the Treasury
and particularly on Wilson, initiated the first phase of anti-inflationary
policies early in 1960. Action was taken on three broad fronts. First,
the government intervened in the 1960 basic wage inquiry and argued that no

11 For an outline of anti-cyclical policy in 1960-62, see, in addition to
the surveys, Waterman, Economic Fluctuations, Ch. 5, and J.O.N.
Perkins, Macroeconomic Policy in Australia, 2nd Ed., (Melbourne
University Press, Carlton, 1975), pp. 11-38. On fiscal policy, see
Policy 1945-66', in Neil Runcie (ed.), Australian Monetary and Fiscal
Policy: Selected Readings, Vol. 1, (Hodder and Stoughton, Hornsby,
increase should be awarded in the basic wage and that automatic quarterly wage adjustments should not be reintroduced - both of these being in opposition to the proposals of the unions. Second, an attempt was made, via the Reserve Bank, to bring under control the excessive liquidity of the trading banks\(^{12}\) by gradually tightening credit policy and by aiming at achieving a balanced budget in 1960-61. Third, in February 1960 virtually all import restrictions were abolished - the rationale being that in the long term resource allocation would be improved and the growth process facilitated; in the short term it would help reduce the imbalance between supply and demand by permitting greater access to goods and services from overseas and thereby drain off some of the economy's excess liquidity.

Import restrictions had been introduced in 1952 as a 'temporary' expedient and over time the Treasury grew increasingly sceptical of their value as an instrument of economic management. The debate at the end of the 1950s over their usefulness and desirability witnessed a clash of rival departmental philosophies. The government's decision in 1960 was considered a significant Treasury victory over the much more interventionist approach advocated by the Department of Trade and pointed to the Treasury's belief that a more competitive environment was necessary for the healthy functioning of the Australian economy. The abolition of restrictions was evidence also of the department's evolving interest in the

\(^{12}\) The highly liquid conditions enjoyed by the trading banks in 1959-60 reflected partly the steady increase in the volume of exports from June 1959 onwards and the consequent improvement in the balance of payments, partly the high level of net capital inflow in 1959-60 which was nearly twice the annual average from 1955 to 1958, partly the Commonwealth government's decision to budget for deficits in 1958-59 and 1959-60, and partly the continued efforts of the Reserve Bank to support the bond market. Waterman, *Economic Fluctuations*, p. 164.
supply side. For unlike conventional stabilisation policies, which aimed at controlling economic conditions by demand management alone, the Treasury's intention in recommending that import restrictions be terminated was to hasten the achievement of balance by increasing the availability of goods and services.

By the middle of 1960 the government judged that further action was required to deal with the boom. Both fiscal and monetary measures were introduced. In May the Reserve Bank issued instructions to trading banks that they make, as the Treasury described it in 1961, 'a prompt and significant cut in their rates of new lending'. In August the government introduced a budget with a nominal surplus of $30 million (the budget result of 1959-60 having been a deficit of $58 million). In an endeavour to achieve a surplus the rate of expansion in government expenditure was reduced and significant tax increases were announced.

These measures were not immediately effective; a persistent downward trend in the level of Australia's international reserves continued. By the end of October reserves had declined by over 21 per cent. Concerned that a balance of payments crisis was immanent it was decided to impose still harsher measures. In November 1960 sales tax increases were introduced, restrictions were announced on the use of interest rate charges as a form of tax deduction, and the Reserve Bank belatedly decided to raise overdraft and fixed deposit rates, thereby squeezing further an already tight credit situation. The sales tax measures were designed specifically to affect the motor vehicle industry: the rate of tax on cars was raised from 30 per cent to 40 per cent, and on motor cycles and scooters from 16.7 per cent to 25 per cent.
The effect on economic activity was abrupt and considerable. From a peak of 25,000 in the September quarter of 1960, the rate of new dwelling commencements fell to 20,000 by the March quarter of 1961. More significant was the decline in motor vehicle registrations. Having reached a peak of 31,865 in November 1960, registrations fell to 22,368 in December and to 16,254 in January 1961. On 22 February it was announced that the sales tax on non-commercial vehicles would be repealed. The unemployment situation deteriorated throughout 1961, increasingly rapidly from 71,115 in January to 89,767 in April. By December it had reached 116,000. In January 1962 a peak figure of 131,500 was attained. Stimulus to the economy was provided by the 1961-62 budget and by a supplementary budget introduced in February 1962. It became clear that the measures of November 1960 had been introduced too late and then too severely; they had accentuated a pre-existing downturn.

(b) **Cyclical Change versus Continuous Progress**

With the onset of recession in 1961 it was not surprising that some attention was given to the notion of cyclical change - something which had been ignored in the surveys of the 1950s. In the 1957 Survey the Treasury had declared:

> No one supposes that, having by 1962 or 1967 made certain headway, our economy will come to a halt.... Probably for as far ahead as matters our economy will continue to grow in some directions if not in all and there will always be a problem, as there is now, of providing in the present for the larger needs of the future. Growth, in other words, is best regarded as a continuous process and the really important thing is the rate at which it proceeds (p. 18).

In 1961, however, the tone was slightly more guarded:

> No boom can go on indefinitely. Even if no official action is
taken to curb it, forces inherent in the boom itself can be expected, sooner or later, to bring it to an end.... The farther the boom has been allowed to go, the more violent the reaction is likely to be once the turning point is reached - possibly leading to widespread business failures and a great rise in unemployment (p. 32).

Two points emerge. First, as discussed in reference to the Keynesian model, the Treasury believed that the very forces producing a boom led eventually to its demise. In an unregulated economy the transition from boom to slump was thus inherent and inevitable. Second, it was assumed that the more protracted the boom, the more painful the inevitable contraction.

It is interesting, however, that the department's faith in continuous progress was dampened only marginally by the recession of 1961-62. In the surveys of the early 1960s the emphasis remained on the continuity of growth rather than on cyclical variation. Elsewhere in the 1961 Survey, for example, the point was made that:

Since some of the forces that make for growth are intermittent, it must itself be somewhat intermittent, a matter of surge and pause, a burst of energy to-day and perhaps a degree of hesitancy to-morrow. These may be no more than undulations in a broad, strong flow of progress - such as we have had in Australia since the war - but their relative magnitudes can be highly important (p. 32).

The underlying image was that of a continuously expanding economy subject not so much to booms and slumps but merely variations in the rate of growth - a river of activity the flow of which, though perennial, varied in volume.

Consistent with such views, inflation rather than unemployment continued to be seen as the major post-war problem. In 1961 the department maintained that: 'In the nature of things, there will always be a recurrent tendency toward inflationary spurts of business activity.' Even
in 1962, with unemployment above normal, the Treasury was able to note that 'we could find ourselves back again, some time hence, in a state of excess demand for goods and materials, labour shortages, heavy importing and rising costs and prices'. Inflation was taken to be a continual threat; unemployment was an uncommon and transient phenomenon.

The Treasury's belief that the dominant characteristic of the post-war period was a persistent tendency toward excessive pressure on available resources paved the way for the adoption of an increasingly neoclassical perspective. For such a tendency, as will be argued in more detail in the next chapter, highlighted the problem of resource scarcity and the problems of choice and efficiency, thereby turning the department's attention toward neoclassical analysis. The notion of continuous growth was also of significance in the transition toward neoclassicism in that it signified that the department's view of the unregulated economy was becoming increasingly more positive. The economy as depicted by the Treasury was like a car climbing a more or less linear path. At times the speed of the car (rate of growth) had slowed to a crawl but was always above zero. At other times, such as in 1954-56 and 1959-60, it had exceeded the recommended limit. But at all times it was climbing upwards and it was this climb which the department focussed on. The Keynesian conception, by contrast, centres on the terrain which the car traverses, on the peaks and valleys which the car passes through, and not simply on its speed. Of course it would have been consistent with a Keynesian perspective to claim that the economy's performance reflected the efficacy of stabilisation policies and indeed Fadden argued along these lines in 1953 and, as noted, in 1958. But the Treasury laid primary emphasis on the power of the expansionary drive. Demand management was an important, but secondary
consideration in the achievement of continuous growth. As the department argued in 1956, the remarkable continuity of growth in the post-war period was a 'spontaneous movement' reflecting 'a general conviction that the economy ought to grow, had to grow, and should not be hindered from growing'. The department was keen to point out that 'there has been nothing in the nature of a general plan, drawn up and imposed by the authority of government'. The post-war period had demonstrated that if a particular goal (in this case economic growth) was adopted by the community as a general belief then that goal could be achieved.

(c) Public Reaction to the Recession of 1961-62

An interesting feature of the 1961-62 recession is that it provoked a much more hostile public reaction than that which occurred during the downturn of 1952-53. At least four factors can be suggested to account for this, some of which are useful in understanding the effect on community attitudes of the depressed conditions of the 1970s and the encouragement this gave to an acceptance of neoclassicism.

First, 1960 marked the apogee of a boom in consumer durables and private houses that had been in progress throughout the 1950s. The proliferation of hire-purchase companies and the marked increase in the volume of their activities (outstanding instalment credit debt rose in real terms by an average of 14.5 per cent a year between 1950 and 1959),

\[13\] This section draws on the discussion in Waterman, Economic Fluctuations, pp. 192-8.

\[14\] Ibid., p. 110.

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reflected this boom. The much greater use of mortgage arrangements and hire-purchase finance in 1960 compared with 1952 meant that more Australians were affected directly by the credit 'squeeze' and the November fiscal measures and by the reductions in overtime and normal earnings caused by the subsequent recession. The increase in debt caused by these measures was bound to cause public hostility.

Second, unlike the Korean War period it was not possible in 1961-62 to project the cause of the downturn largely onto external forces - such as the collapse of wool prices. Lydall expressed a common sentiment early in 1962 when he referred to the experience of the preceding twelve months as 'Australia's first independent slump'. It was widely believed that the blame for the downturn rested squarely on the shoulders of the government and its incompetent advisers. The significance of other factors contributing to the downturn, such as the achievement of saturation points in a number of consumer durable markets, was frequently neglected in popular discussion.

Third, even in supposedly informed discussion there was a tendency, according to Waterman, to exaggerate the extent of the recession. He maintains that the unemployment statistics provided by the Department of Labour and National Service were 'highly misleading' because they did not take into account the increased use of the Commonwealth Employment Service, especially by women, which had occurred since the early 1950s. He argues

16 Waterman, Economic Fluctuations, p. 194.

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further that an incorrect diagnosis of trends in GNP arose 'partly because the first version of the national accounts published by the CBCS, both in quarterly and in annual form, overstated the decline in 1961 and understated the recovery in the next two years, and partly because adequately deflated series did not become available until 1964'.

Fourth, and most important, at the end of World War II it was commonly held that there would be a short and intense post-war boom followed inevitably by a slump, so that when the downturn came in 1952 it merely confirmed what had been widely expected. Moreover, to a generation which had clear memories of the 1930s the extent of unemployment and the duration of the slump seemed negligible and led to a revised interpretation of the notion of economic downturn. 'Depression' became an obsolete phrase of use only in history texts; any downturn was now to be described as a 'recession'. The fact that there was a steady increase throughout the 1950s in the percentage of householders purchasing their homes and consumer durables by instalments was indicative of the growing confidence in Australia that the traditional trade cycle was largely a thing of the past. As Waterman puts it: 'The combination of job security and continually rising money earnings made instalment credit a sound and attractive method of increasing living standards - a poor man's hedge against inflation.'

17 Ibid., p. 197.

18 See ibid., p. 160 for the figures.

19 Ibid.
decade was captured in Fadden's comment in 1959 that: 'Australia has succeeded in establishing improved industrial relations and a degree of economic, social and political stability unparalleled in our own national history and, taken in combination, not surpassed, I believe, by any country in the world today.'\textsuperscript{20} After 1952-53 the maintenance of unemployment a few decimal points either side of 1.5 per cent was taken for granted. In 1954 Karmel could claim that: 'In Australia no government which tolerated any appreciable unemployment would survive an election.'\textsuperscript{21} When in 1961 the official statistics showed that unemployment was above 2 per cent and when it continued as such for nearly twelve months (after reaching a peak of 3.1 per cent in January 1962, a post-war record), it was not surprising that the result was deep disappointment and dissatisfaction. As was to be repeated in the 1970s on a larger scale, the public reaction was a product of over-confidence in the government's ability to fine-tune the economy.

\textbf{(d) Economic Planning versus Demand-Management}

The 1930s and 1970s demonstrated that periods of economic crisis tend to produce popular demands for a system embracing either greater collectivism or greater individualism as a solution to economic instability. While the recession of 1961-62 can hardly be called a crisis, it is interesting


nevertheless that the perceived failure of the system led to widespread calls for the introduction of economic planning along French or Japanese lines, at the very least for the establishment of research bureaux responsible for plotting the dimensions of long-term future economic trends. E.L. Wheelwright, for example, maintained in 1962 that: 'The techniques used in Canberra, which masquerade as planning, are still basically those of Keynes. But our problems have slipped out of the Keynesian framework.... Keynesian techniques are not enough; we need a modern means of propulsion.' 22 The idea that there might be an alternative to the Treasury, such as a separate department of planning, received substantial support. A.R. Hall suggested in 1962 that a planning section be established in the Prime Minister's Department and stressed that such a section should not be located in the Treasury. 23 Other commentators, such as Heinz Arndt, believed that indicative or target planning should be left to the Treasury. 24 H.B. Turner, in a speech to Federal parliament in 1962, argued that the Treasury should have two ministers, a Minister for the Budget and the Minister for the Economy, the latter to be in charge of a long-term planning section staffed by 'high-powered people'. 25

In 1965 debate on long-term planning re-emerged following the


publication of the Report of the Committee of Economic Enquiry. The Committee was headed by Sir James Vernon and included J.G. Crawford (the former Secretary to the Department of Trade), Professor P.H. Karmel, D.G. Molesworth and K.B. Myer. The Menzies Government appointed the committee early in 1963 in an attempt to take some of the sting out of current dissatisfaction with economic management. There is a touch of irony in the fact that one of the recommendations of the committee was that an advisory council on economic growth be established, using as a model the Economic Council of Canada which had been set up in 1963. The committee, however, made it clear that it did not favour 'anything in the nature of a national economic plan involving individual industry targets for Australia, as this would require elaborate machinery and, in all probability, a considerably higher degree of government intervention in the economy than would be acceptable in this country'. The functions of the council would be restricted to such things as preparing reviews of long-term growth prospects, reporting on topics referred to it, and acting as a consultative forum. Under the influence of the Treasury, which saw the proposed council as a threat to its economic authority, Menzies denounced the committee's idea. Seemingly misinformed, he declared:

In the Australian democratic system of government based upon the consent of a free community, no government can hand over to bodies outside the government the choice of objectives and the means of attaining them in important fields of policy, particularly when such bodies would, through the power of publication, come to exercise what I have described, I hope not extravagantly, as a coercive influence upon governments.  

Underpinning the advocacy of planning was a belief that the government as such was not at fault for initiating the system's apparent breakdown. The object of complaint was the short-sightedness of existing techniques of economic management, which were not only often impotent in the face of inherent cyclical instability but could quite possibly exacerbate it. To those who advocated planning the appropriate answer to the system's tendency toward instability seemed to be to dispense with myopia by establishing a more pervasive, more far reaching style of economic control.

But it is quite possible that in some quarters the experience of 1960-62 produced the opposite reaction: the disruptive and potentially self-defeating nature of anti-cyclical policies became apparent and lent favour to the idea of abandoning fine-tuning for a widely understood and accepted, and slowly changing, set of rules under which individual economic agents could pursue their maximising activities.

It is interesting in this respect that the response of the authors of the economic surveys to the instability of the early 1960s was simultaneously to reject planning and to claim that there were distinct limits to the government's ability to mould the economy. The Treasury's plea was for greater economic rationality. There was no need for any more government involvement in the economy than was occurring already. The fundamental answer to instability lay in the exercise of restraint, cooperation and reasonableness by the community. There was scope, however, for improving fiscal, monetary and other techniques of demand management and in line with this the 1960s witnessed a continual enlargement of the range of the national accounting estimates and the adoption of increasingly
more sophisticated methods for gauging the effect of the annual budget.

Three key objections to planning were articulated by the Treasury. The first related to the target setting and forward calculations upon which the exercise depended. Serious doubts were held as to whether targets for, say, five years could be constructed with sufficient accuracy for the purposes of economic planning. The need for central targets to be dependable was 'crucially important': 'If they proved too high, it could bring on the familiar troubles of trying to do too much with too few resources. If they proved too low, it could produce frustration and loss on the part of those enterprises which found themselves capable of doing more than the targets provided for them.' Given the difficulty of estimating even short-term trends, the likelihood of the targets missing the mark was high. As such, it was quite possible that planning would ultimately be 'disruptive and discouraging'.

A second objection related to Australia's continued dependence on overseas trade. While the economy had exhibited a greater resilience in the face of export fluctuations, unstable overseas earnings could still be 'highly disruptive' and there were doubts about whether economic planning could be 'sufficiently protected' against such disruptions.

The third and major objection to planning was its potentially harmful effects on the notion of free enterprise. The Treasury was


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concerned that planning might limit individual initiative and stultify growing and enterprising firms by attempting to impose rigidity and certainty upon a system which was inherently unpredictable, uncertain and constantly changing. Moreover, the private sector, in which resided the source of capitalist drive, might be rendered impotent if planning resulted in the subordination of the judgement and aspirations of the individual beneath a collectively determined, but nevertheless fallible, formula.

Having rejected long-term planning, the department stressed the need for 'more and better statistics', for the government 'to state the main objectives it has in view and define the broad policies by which it will seek them', and for 'continuous and effective consultation between the central government and all the main constituents of industry, commerce, finance and labour [so as to achieve] an adequately informed common mind on the problems in which all have a share and towards the solution of which all must co-operate'.

The Treasury remained loyal to the concept of demand-management, however, believing it to be all that was necessary in the way of government intervention. In defiance of the widespread dissatisfaction with stop-go policies, it argued in 1961 that anti-cyclical measures were means not ends and should be adapted to the changing economic conditions, so that what was required was not less but greater flexibility. The department advanced a straightforward Keynesian viewpoint:

Whether changes in the charted course need to be sharp or slight will, obviously, depend on the behaviour of the economic weather. In smooth conditions, only small steering changes should be needed, provided the course has been properly charted beforehand. But the economic world is subject to sudden upheavals; markets can, for example, react strongly to events, whether expected or unexpected. Some sharp changes in direction are therefore hard to avoid at times (pp. 37-8).
Nevertheless, the surveys of 1961 and 1962 showed a growing awareness of the difficulties in implementing anti-cyclical policies. Discussing the boom and subsequent downturn, the Treasury pointed with vindicatory overtones to the difficulty of deciding when and to what degree corrective measures should be introduced: 'it is not always easy to judge what form action should take, how strong it should be or how long it should last'; economic forecasting was 'not a matter which lends itself to scientific accuracy'. Reference was made also to the political difficulties of demand management, the fact that election conscious governments were often reluctant to increase taxes and tighten monetary policy to restrain buoyant conditions.

It is interesting that even in 1959 the department was arguing that fiscal policy was not a panacea and that, on the contrary, it could in fact sometimes be destabilising:

Since the war we have seen enough to know that, pursued too zealously and using chiefly monetary or fiscal means, policies aimed at over-rapid expansion are likely to prove self-defeating. They quickly lead to inflation of demand for goods and resources. This brings on shortages of labour, materials and equipment which retard production and cause prices and costs to rise. They also cause excessive demands for imports which lead to import restrictions, in turn a source of cost increases.... It is not suggested of course that monetary and fiscal action is risky under all circumstances; at times it can be used beneficially and it may need to be used boldly. The real point is that, while such measures can play a part, they will, if carried beyond due bounds, accentuate the basic difficulties of national growth (pp. 26-7).

As in earlier surveys, the argument being advanced was that there were distinct limits within which the growth process should occur. Phrases such as 'too zealous', 'over-rapid' and 'carried beyond due bounds' were indicative of the Treasury's concern that growth pursued too rapidly would entail harmful spiralling effects. It would seem that the department's
motto was that if one is to use monetary and fiscal policies to stimulate the economy, it is better to err on the side of conservatism. Within the sphere of financial management this had been a long-standing Treasury principle. It now seemed equally applicable within the sphere of economic management.

A further point made in the 1959 Survey was that there had been a tendency to over-estimate the scope and efficacy of fiscal and monetary policies in maintaining high levels of growth. The Treasury's reasoning was that to maintain growth it was essential to maintain the flow of imports; a satisfactory level of imported goods and services underpinned the possibility of growth. But imports had to be paid for. Therefore, to avoid balance of payments problems export earnings had to increase. But to increase exports was considered particularly difficult. One thing that was clear, however, was that prices and costs were a critical factor in export success. The government could help secure the pre-conditions for export success by maintaining a reasonably high level of internal economic activity. But a high level of activity, though essential for the continuation of growth, could not by itself ensure cost advantages and export success. The Treasury declared: 'there is far more to our total economic problem than the matter of keeping up a high level of internal activity'. Further, 'It will take far more than an occasional touch of budgetary or credit expansion to provide us with the additional exports we need.' The imperative need was for community determination to keep prices and costs as low as possible, to improve productivity and to maintain an adequate level of savings. Only then could exports flourish, international reserves be maintained at a satisfactory level and the imports essential for continuous growth be forthcoming.
As this suggests, individual and community responsibility was considered the crucial determinant of the efficacy of government economic policies. In 1960 the Treasury endorsed Menzies's argument that community effort was the only way to overcome community problems. In 1961 it suggested that organised groups - whether they be sellers, buyers, producers or trade unionists - had the leading part in controlling inflation. Businessmen, for example, had 'a big responsibility in the matter of cost and price stability'; 'if businessmen do not strongly resist pressures that would result only in the raising of costs and prices, there will be faint hope of continuing stability in this field'.

There was no point in blaming any particular group for inflation. The question of whether wages caused prices to rise or the other way around was considered 'a sterile question if its purpose is merely to sheet home the blame'. Trade unions, business firms, arbitration tribunals, interest groups and individuals, and not just governments as monetarists suggested, were responsible for inflation; the solution to the problem of inflation lay ultimately in the hands of all those whose spending decisions went to make up aggregate demand. Government demand-management was an important weapon with which to control inflation but, as noted, it was community cooperation which underpinned its efficacy.

Conclusion: Reconciling Individualism and Economic Responsibility

The Treasury's comments on community responsibility point to a fundamental difficulty in the Keynesian model: the problem of combining individualism and economic responsibility; in particular, the question of maintaining discipline in a social-democratic society subject to continuous high levels.
of employment. Keynes believed that the notion of economic control was in fact a policy of liberation. Governmental regulation of the economy would extend only to regulating aggregate demand, leaving individuals, now no longer shackled by the fear of mass unemployment, free to exercise choice and initiative. As Keynes put it:

Whilst ... the enlargement of the functions of government, involved in the task of adjusting to one another the propensity to consume and the inducement to invest, would seem to a nineteenth-century publicist or to a contemporary American financier to be a terrific encroachment on individualism, I defend it, on the contrary, both as the only practicable means of avoiding the destruction of existing economic forms in their entirety and as the condition of the successful functioning of individual initiative.

Keynes was convinced that despite the 'large extension' which he proposed in the traditional functions of government, 'there will still remain a wide field for the exercise of private initiative and responsibility. Within this field the traditional advantages of individualism will still hold good.' Underpinning Keynes's mid-liberal stance was a belief, perhaps not in the perfectability of man but in the possibility of gradual and continuous improvement, a belief that human nature, although heavily influenced by irrational forces, could still be persuaded to 'see the

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31 Ibid.
light', to act reasonably, to collaborate, to solve problems collectively. Keynes never abandoned his early meliorist stance. He was convinced that the irrational attitudes of individual economic agents could be counter-balanced, possibly corrected, by the actions of the wise and intelligent technocracy overseeing the system. He did not consider in any detail, however, the possibility that governmental success in regulating the level of economic activity might jeopardise the concept of community consensus and co-operation. Keynes insisted that: 'The right remedy for the trade cycle is not to be found in abolishing booms and thus keeping us permanently in a quasi-slump; but in abolishing slumps and thus keeping us permanently in a quasi-boom.'

But the problem with an economy which is kept permanently in a quasi-boom is that, as the Treasury discussed at length in the surveys of the early 1960s, there is continuous pressure for wage increases and a risk that such pressures will become cumulative. Furthermore, such conditions are conducive to the passing on of cost increases by employers in the form of commodity price increases. The potential such conditions give to a conflict between individualism and economic responsibility is, as suggested, a fundamental difficulty in the Keynesian model. Whether Keynes would have accepted the neo- or post-Keynesian suggestion that the solution to the problem lies with the imposition of incomes policies is not clear.

After fifteen years of experience with continuous high levels of employment, the evidence in this chapter suggests that the Treasury continued to sympathise with Keynes's Weltanschauung. It believed that

32 Ibid., p. 322.
with reasoned arguments, with sustained cajoling and exhortation, attitudes could be changed and there could be such a thing as 'an effective community stand against inflation'. Its faith was that there need be no conflict between individualism and economic responsibility in a situation of continuous high employment. To the extent that there was a conflict, the answer lay neither in increasing unemployment nor in restricting individualism. Rather, it lay in remoulding the ideas and attitudes of individuals so as to encourage greater self-discipline and the adoption of a broader, more community-minded stance.

But beneath a veneer of optimism there was tension in the Treasury's outlook. For while it clung to a belief in the possibility of human malleability, the surveys of the early 1960s were full of arguments about trade unions persisting in attempts to gain higher wages, about employers acceding to these demands and, as noted, about the political difficulties involved in implementing effective anti-cyclical policies. In the surveys of the 1950s the image of man presented was that of a myopic creature concerned only with the present and ignorant of future possibilities. He was concerned only with himself and with the gratification of his consumption needs and was oblivious to the collective results of such action. He was reluctant to save; often he borrowed other people's savings so that he could spend that as well. Such an image undermined the self-restraint solution. It sat uncomfortably next to the confident assertion that economic control was possible. In short, reality seemed to betray the Treasury's ideals and over time the assumption of malleability became increasingly tenuous in the department's eyes. By the mid-1970s, as will be seen in Chapters Eight and Nine, the notion of community co-operation had come to be considered naive. It was replaced by
a belief that the most effective safeguard against excessive wage claims was to violate the sacrosanctity of full employment and create a pool of unemployed sufficiently large to counteract avaricious tendencies.
Chapter Seven: **Resilience, Steadiness and Stability: 1963-67**

The recession which began late in 1960 lasted until early 1963. By the end of 1963 the economy had entered a phase characterised by high and improving growth rates, price stability and low unemployment. This phase of balanced growth, to use the Treasury's expression, persisted until the end of the 1960s when inflation re-emerged as a serious problem.

This chapter covers the halcyon period, 1963-67, and discusses the continued move toward the supply side (particularly evident in the Supplements to the Treasury Information Bulletin published in the mid-1960s) and the department's conviction that the economy was growing ever stronger and more resilient so that it was becoming increasingly able to look after itself. The chapter considers also developments in economic policy, particularly the problems posed by the rapid escalation in defence spending which occurred during the 1960s.

**The Economy's Increasing Resilience**

Reference was made in the previous chapter to Fadden's claims at the end of the 1950s that the Australian economy was now much stronger and more resilient so that it could continue to grow in the face of serious droughts and substantial losses in rural income. The economy was described also as being much more diversified, as having a strong manufacturing sector, so that it could now better withstand the vagaries of international markets for primary goods.

The image of a strong and resilient economy was particularly
appealing to Australians. Its appeal reflected in part the conviction that a sound, growing economy was a key means to full employment and rising living standards. Its appeal reflected also fears borne out of geographical isolation, fears of invasion from Asian communist 'hordes' - Australia being the last domino in a line stretching from China. The only way to counter these threats, apart from alignment with the United States, was to industrialise quickly. For it was believed that economic strength ensured economic security.¹ The image of a strong domestic economy able to progress in the face of overseas recession was appealing also because it soothed the psychological wounds inflicted in the 1930s when Australia's dependency on Great Britain became all too obvious. As Schedvin explains, during the depression Australia was 'forced into isolationism without knowing how to chart her future destiny'.² It was felt that 'the rest of the world had turned its back on Australia and her difficulties'.³ The lesson was to seek independence and to do this through greater self-sufficiency. World War II reinforced this lesson.

Roland Wilson, Secretary to the Treasury until 1966, had long been preoccupied with Australia's dependence on international markets

¹ Just after the outbreak of the Korean War in 1950, Fadden could claim that Australia was 'in the midst of a vast and many-sided movement of expansion'; one of the principle forces contributing to this was 'the need for security, brought before us so urgently in recent times, and the recognition that for economic security we must have far greater economic strength'. Budget Speech 1950-51, CPD, Vol. 209, 12 October 1950, p. 763.


³ Ibid., p. 254.

273.
and in 1962 he continued to press the point:

The Australian economy is more dependent than most on international trade, with exports and imports equivalent to about 13 per cent of the gross national product in recent years. Over 80 per cent of export receipts are still derived from wool, wheat and flour, meats and other primary products, the prices of which are determined by market conditions abroad whose production is subject to the vagaries of the seasons. Imports, about four-fifths of which consist of capital equipment and supplies for Australian industries, also fluctuate considerably, reflecting strongly the periodical strengthening or easing of the pressures of demand in a rapidly developing economy.5

From 1963 onwards, however, the notion that the domestic economy was becoming ever more resilient re-emerged as a theme in Treasury documents. It was to feature prominently in discussions at the end of the decade. The department pointed with pride to Australia's improving growth record as a sign of the nation's increasing strength. From 1953-54 to 1958-59 gross national product at constant prices grew at an average annual rate of 4.4 per cent, improving only slightly to 4.5 per cent in the period 1958-59 to 1963-64. From 1963-64 to 1968-69, however, the average growth rate was 5.2 per cent. This latter figure was all the more impressive because serious drought suffered in 1965-66 and again in 1967-68 dampened the overall growth rate; throughout the second half of the 1960s the non-farm sector grew in constant prices in excess of 6 per cent a year. In

4 Wilson's doctoral research at both Oxford and Chicago was on capital imports into Australia and the terms of trade. Wilson summarised some of his findings in Capital Imports and the Terms of Trade, Examined in the Light of Sixty Years of Australian Borrowings, (Melbourne University Press, Carlton, 1931.

1964-65 private fixed investment was nearly 50 per cent above the figure attained in 1961-62 and this was taken as another sign of the economy's strength. The Treasury pointed also to the fact that in the ten years to 1968-69 Australia's labour force grew by about one-third (the increase in the proportion of women entering the labour force was nothing short of 'phenomenal') and output rose by over 60 per cent.6

Writing in 1970 Richard Randall, who had succeeded Wilson to the Treasury Secretaryship, argued that World War II was a watershed in Australia's path toward industrialisation. Prior to the war 'there had been little in the way of conscious determination to develop an economy capable of self-sustained growth'. Australia was dependent on its rural sector to an extent that 'the fortunes of the farmers and those of the rest of the economy tended to move in parallel'. The war, however, provided a strong stimulus to widen the domestic industrial base and suggested a need for a larger population and a more skilled labour force. The industrialisation process was such that by the end of the 1960s primary industries contributed only 9 per cent to GNP, whereas in the mid-1950s the figure was 15 per cent. Moreover, whereas manufactures made up only 5 per cent of exports at the beginning of the 1950s, it now made up 18 per cent. And by 1968-69 mineral exports represented 20 per cent of total export receipts. All this indicated that Australia was now much less dependent on its traditional primary exports. As Randall put it: 'the fortunes of the economy are no longer as closely tied as they once were to

6 These statistics are from The Australian Economy 1969, (Commonwealth Government Printer, Canberra, 1969).
the vagaries of the seasons, or of overseas influences on the price of one or two commodities ... the country has now become sufficiently well diversified and developed to withstand temporary reversals in overseas trade'.

Two important factors contributing to the resilience of the Australian economy were the immigration programme in force throughout the post-war period and a high and continuous inflow of capital from abroad. To deal first with the former, not only had the immigration programme provided an absolute increase in the size of the labour force but migrant workers had increased the level of skill in the labour force and had contributed significantly to various important construction projects, such as the Snowy Mountains scheme. Randall argued in 1970, with neoclassical overtones, that the influx of immigrants had contributed also 'to the mobility, flexibility and adaptability of the work force, and has consequently made it easier for the economy to adapt itself to changes in the pattern of demand'. In addition, by increasing Australia's population the steady flow of immigrants had enlarged the size of the domestic market and thereby provided a stimulus to economies of scale. To the Treasury, such advantages outweighed the fact that the immigration programme had placed some limits on capital deepening.

As for capital inflow, it had performed the valuable role of increasing technical expertise in Australian industry and, more

8 Ibid., p. 10.
particularly, of augmenting domestic savings and thereby helping to maintain overall savings at an adequate level - which, as discussed in the previous chapter, was such an important Treasury desideratum. In 1965 in a seminar in New York, Roland Wilson pointed out that:

A few years back, when we were still actively making public issues in the New York market, I detected some tendency on the part of financial writers to describe Australia as 'the world's most indefatigable borrower'. That is a nice tribute, but it tends to conceal a much more important truth: that we are just about the most indefatigable investors of our own money. 9

He noted that from 1959-60 to 1963-64 gross investment expenditure amounted to some 26 per cent of gross national expenditure, whereas in the period 1958-62 the corresponding figure in the United States and Great Britain was 17 per cent, in Canada it was 22 per cent, and in the EEC, 24 per cent. Perhaps a more important statistic was that about 90 per cent of total investment expenditure in Australia was provided by internal sources. Overseas sources filled the hiatus. Boehm points out that during the 1920s net capital imports accounted for nearly 20 per cent of gross fixed capital expenditure and then fell dramatically to less than 8 per cent during the 1930s. Throughout the 1950s and for the first half of the 1960s the figure remained steady at around 9.6 per cent and then increased to 10.5 per cent from 1965-66 to 1968-69. Boehm's conclusion in 1971 was that: 'The fact that Australia now relies much less heavily on overseas borrowing to finance rapid economic growth than she did previously is a mark of the increasing strength of her general economic position and of her greater

economic maturity. The Treasury, no doubt, agreed. Boehm noted, however, that private overseas capital had come to play a much greater role in the post-war period. In the period 1950-51 to 1954-55 private overseas investment as a proportion of gross private fixed capital expenditure stood at 11.9 per cent. This grew steadily so that by 1965-66 to 1968-69 it had reached 19.3 per cent. Throughout the 1960s this upward trend provoked concern about the extent to which Australian industries were owned and controlled by overseas interests and raised questions as to the extent to which Australia was really becoming more independent. According to John Gorton, such questions were of no great concern to the Treasury. He complained in 1971 that: 'There was, in the Treasury, an almost pathetic dog-like gratitude for foreign investment.'

Australia had also greatly benefitted from the discoveries in the early 1960s of vast reserves of bauxite, copper, iron ore and oil. To the authors of the 1963 Survey, the significance of these mineral discoveries could hardly be overstated: 'Over the past ten years, especially over the

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11 Ibid., p. 109.


past three years, Australia has achieved the greatest breakthrough in point of resources since the crossing of the Blue Mountains a hundred and fifty years ago.' Such discoveries held the promise of converting Australia into 'a great industrial nation' capable of supporting a large population. Mineral discoveries continued throughout the 1960s until they almost came to be taken for granted. Largely as a result of these discoveries, the Treasury could argue in the 1969 Survey that the economy had matured. Its range of activities had widened, the business world was enjoying a 'new confidence', and the Australian capital market, stronger and more diversified, had a much greater capacity to mobilise capital. In short, 'The economic foundations are undoubtedly much stronger and wider than they were ten years back.'

By the end of the 1960s Australia had also become much less dependent on Britain; the latter's share of Australia's trade having declined by more than 50 per cent since 1950. By 1968-69 Japan had become Australia's main export customer (accounting for 24 per cent of total exports) and the United States the main source of imports (supplying 26 per cent of total imports). A symbol of Australia's changing relationship with Britain occurred in 1967 when the British government devalued sterling. The Australian government, on Treasury advice, decided not to follow suit. In the previous year it had been decided to abandon pounds, shillings and pence and adopt decimal currency. As Horne points out, these initiatives were 'taken as an important assertion of Australia's independence, perhaps unparalleled in financial matters since the decision

in 1910 to establish an Australian currency'.

As with the belief in continuous progress and the tendency to abstract from the importance of cyclical change, discussed in the previous chapter, the idea that Australia was stronger, more diversified and resilient, indeed mature and increasingly independent, signalled within the Treasury a positive interpretation of the economy's inherent proclivities. Economic management was deemed to have played an important part in the economy's performance but by no means the most important part. The economy's increasing strength was derived largely from internal sources. As time went on the evidence to the Treasury was that the economy was becoming increasingly able to look after itself. If government intervention had largely been justified in the past because Australia was a young, developing nation dependent upon the infrastructural support provided by the public sector and because corrective measures were needed to place on an even keel an economy subject to the constant upheavals of international markets, then it now seemed less warranted. The lesson drawn was that to the extent that the economy was now better able to look after itself, the less pervasive, the less frequent and the less drastic should governmental regulatory activities be.

Defence Expenditure and Budgetary Policy

Despite the strong performance of the economy, a number of difficult budgetary problems arose in 1963-67 brought about mostly by the rapid

increase in defence expenditure occasioned by the Vietnam War. Commonwealth defence expenditure rose from $411 million in 1962-63 to $1041 million in 1967-68, an increase of 153 per cent. The most dramatic increases occurred in 1965-66 and 1966-67 when defence expenditure jumped by 23 per cent and 28 per cent respectively in nominal terms. From 1962-63 to 1967-68 there were strong increases also in public capital expenditure which rose by 101 per cent from $81 million to $163 million. Over the same period total net expenditure on goods and services by the Commonwealth government grew by 122 per cent from $820 million to $1823 million and total transfer payments rose by 52 per cent from $2285 million to $3472 million.16

The problem facing the government was that the increases in expenditure occurred at a time when resources in the economy were already fully employed. Holt explicitly acknowledged in the 1964-65 budget speech that the large increases proposed in public expenditure, particularly in defence expenditure, threatened the continuation of stability because 'our resources are already fully committed'.17 In the 1965-66 budget speech the Treasurer announced that 'a greatly enlarged expenditure on defence, a substantial increase in payments to State governments, further growth in social welfare payments, increased international aid and increases in many other items encompassed in the Budget as a whole', which together would result in 'the largest expenditure increase for which a Commonwealth Budget


has ever had to provide'. Although revenue would rise strongly it would be 'substantially short' of the expenditure proposals. All this, however, was occurring at a time when 'the home economy has been and still is running at full pitch, with little if any current labour resources to spare', at a time when aggregate demand had been exceeding supply for over twelve months, resulting in 'a fairly strong and continuous' increases in costs which no doubt would soon be revealed in the prices of goods and services. The Treasurer concluded: 'Clearly there are dangers in all this - serious dangers of disruption and instability.'

Disruption and instability, however, were largely avoided. For while public sector expenditure grew strongly there was a notable slow down in 1965-66 and 1966-67 in other forms of expenditure, particularly consumption expenditure. The restraint shown in consumption expenditure reflected in part the success of policy initiatives, particularly taxation increases imposed in 1964 and 1965, designed to dampen such spending. Another dampening force was a severe drought experienced in New South Wales and Queensland in 1965-66 - which also affected the level of farm investment. In addition, as the Treasury pointed out in the 1966 Survey, it seemed that there had been 'a high degree of restraint on the part of the buying public or, what is the obverse of the same thing, of voluntary saving', this being partly a legacy of the debts incurred during the recession of 1961-62.

The restraint in consumption expenditure from 1963 to 1967 enabled relatively high growth rates to be coupled with substantial increases in public sector spending without the appearance of boom conditions. Indeed in the 1966-67 budget speech the Treasurer, William McMahon, who succeeded Holt to the Treasurership early in 1966 after the latter became Prime Minister, argued that the slow-down in the rate of consumer spending, an apparent decline in private capital expenditure, together with the lingering effects of the drought, necessitated some stimulus be given to the economy. He declared: 'Within limits the Government wants the Budget to be expansionary. Indeed, if the Budget were not expansionary we would be taking other measures to ensure that expansion took place.' In the 1967-68 budget speech McMahon could announce that over the previous twelve months aggregate supply and demand 'seem to have been pretty much in balance'. There were, however, worrying signs. In the first three quarters of 1966-67 the consumer price index rose at an annual rate of just over 2 per cent. But in the last quarter the rise in the CPI was equivalent to an annual rate of 5 per cent. And in the twelve months to June 1967 minimum weekly wage rates rose by 7 per cent. These were taken as signs of growing stress in the economy, signs that demand was increasing too rapidly.

The escalation in defence spending between 1963 and 1967 was

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20 McMahon was the first Treasurer to have any sort of formal economics training. In addition to having a Law degree he was a graduate in Economics from the University of Sydney.


significant not only because of the problems its seeming inexorability raised for economic management but because it highlighted in a dramatic way the problem of resource allocation and because it raised questions about the achievement of balance in the expenditure patterns of the public and private sectors. In the 1966-67 budget speech McMahon argued that the rapid build-up in defence, given that it was imposed on a fully employed economy, 'involved a substantial transfer of resources so that some activities had to be held back in order that others could go quickly ahead'. Consumption expenditure had been restrained by taxation increases 'in order to release resources for defence purposes and for other high priority uses'. The steep increases in defence spending raised 'profound issues of national priorities': 'with each successive rise in defence expenditure, we have become increasingly conscious of a developing conflict between major national purposes - between the requirements of defence and those of growth. This conflict was 'real and substantial'. Accordingly, in framing the budget the government had been forced to make 'difficult choices'. McMahon declared that there had been no easy way out.23

In the 1967-68 budget speech the Treasurer argued that an imbalance had arisen between the public and private sectors, pointing out that public authority spending as a proportion of gross national expenditure had grown from 19 per cent in 1962-63 to 21 per cent in 1966-67 and that in the previous two years the public sector had absorbed 44 per cent of the rise in total employment compared with 25 to 30 per cent 'a few years back'.24

24 Boehm points out that in 1948-49 total government expenditure comprised 14.4 per cent and that by 1967-9 the figure had climbed to 284.
The government was faced with 'the problem of choice and allocation': 'Pressed hard by competing claims, we had to decide what the broad allocation of resources should be.' The result was a decision to reduce the rate of increase in public sector spending in 1967-68 to 9.5 per cent (the rate of increase in the previous year being 11 per cent).

In explaining the basis of this decision the Treasurer claimed that there was a need 'to provide room for balanced expansion of the private sector'. At this stage there was no suggestion that public sector expenditure should decrease in absolute terms - indeed McMahon stated that public sector expenditure 'grows inevitably year by year', that to a large degree the budget was 'pre-determined by past commitments', and that 'these necessities could not be denied and they are likely to increase' - but the clear suggestion was that the growth of the public sector had constrained the development of the private sector and that this necessarily was undesirable. The suggestion also was that there was some sort of appropriate level of public sector expenditure which represented a balanced situation and that in order to achieve this situation a decline in public sector spending in relative terms was essential.

From the point of view of the Treasury's evolving model, such comments are interesting in that they constitute an early manifestation of the crowding-out hypothesis and the notion of 'abnormal' public sector expenditure.

25 Budget Speech 1967-68, p. 14
26 Budget Speech 1967-68, pp. 6,7,9.
spending commitments, two ideas which were to figure prominently in the department's outlook in the 1970s and which have sometimes been assumed to have been provoked solely by the actions of the Whitlam Government. Whereas in the Keynesian model the government is the deus ex machina which rescues an inherently faulty system from collapse, the Treasury's comments on the public/private sector imbalance and those discussed in the previous chapter on the risk of using budgetary and monetary policy to push the economy too rapidly along a particular growth path, indicate an increasingly negative view in the department of the role of government. This view was combined, as noted, with a growing belief that governmental intervention was becoming progressively less justifiable in light of the economy's obvious internal strength and solidity.

Further Moves to the Supply Side

It could be argued, with justification, that budgeting, by definition, has and always will involve 'hard choices' and allocative decisions and that McMahon's statements in 1966 and 1967 were therefore nothing particularly novel. It can be shown, however, that there was indeed a heightened interest in the Treasury in the mid-1960s in the questions of choice and efficient resource allocation and how they applied in everyday life and not just in budgeting. Of particular relevance in this regard are the spate of supplements to the Treasury Information Bulletin which appeared between 1964 and 1966 and a special section appended to the 1967 Survey entitled 'Resources and their Allocation'.\footnote{The Australian Economy 1967, (Commonwealth Government Printer, Canberra, 1967), pp. 23-30.} In these documents the evidence is
clear that the Treasury was moving progressively toward the supply side.

The supplements were a product of the GFEP's Economic and Financial Surveys Division, which was established in 1962. The function of the division was to develop programmes of research into areas such as the following:

(a) Forward expenditure plans of public authorities in Australia and estimates of their assessment of their expenditures for a period of years ahead, with an assessment of the implications of these estimates particularly for the Commonwealth Budget;

(b) Estimates of private expenditure for a period of years ahead;

(c) Estimates of gross national product, gross domestic expenditure, total market supplies and total market expenditure (and the main elements thereof) for a period of years ahead, with an assessment of the implications for economic and financial policy;

(d) Trends in the Australian population and the growth of the work-force, both from natural increase and immigration;

(e) Forward estimates of the balance of payments for a period of years ahead.28

The Division was divided into two sections. Functions (a), (b) and (c) were the responsibility of the Expenditure Survey Section, while functions (d) and (e) were the responsibility of the Resources Section.29

The establishment of the division should be seen in the context of the growing concern in Australia and overseas (later to be highlighted in


29 Ibid.
Australia by the Report of the Vernon Committee) with assessing and coordinating long-term possibilities and trends. It seems clear that the division was in part a defensive action designed to placate the widespread demands, discussed in the previous chapter, that economic planning should be adopted as a governmental strategy to deal with economic instability.

As the Sydney Morning Herald put it:

it is peculiarly Australian as the wombat that our nearest equivalent [to the French planning machinery] remains an embryo, cuddled safe, unseen, oblivious to the outside world, as a new branch established in the womb of the Federal Treasury, a department which publicly disparaged the idea of target planning in a White Paper published a few years ago. Once again the gesture has been made; the defensive reflex action, empty of purpose, has been taken.  

One of the first tasks of the Resources Section was to prepare various papers for the Vernon Committee on the following topics: the balance of payments, overseas investment in Australia, the availability of credit, the growth of domestic saving and investment, capital requirements, public borrowing overseas, the financing of public works, and projections of the work force. Several of these papers were later to form the basis of supplements to the Treasury Information Bulletin published in the mid-1960s. Four of these supplements are discussed here: The Meaning and Measurement of Economic Growth (November 1964); Projections of the Workforce, 1963-76 (April 1965); and The Australian Balance of Payments and Investment Analysis (February and July 1966 respectively).  

32 All were published by the Commonwealth Government Printer, Canberra.
A persistent theme in the supplements was the difficulty, even the impossibility, sometimes the risks, of attempting measurement in the form of forecasts and projections. In *Economic Growth*, for example, it was argued that:

Since economic growth can be strongly influenced by changes in determining factors that are either unforeseeable or beyond accurate prediction, forecasts of rates of growth, whether actual or potential, are necessarily subject to varying degrees of error ... not nearly enough can be known about the complex surrounding circumstances to permit anything better than a broad assessment of what growth might have been had all its potentialities been realised. Estimating the potentialities of the future will, of course, present still greater difficulties (p. 5).33

Similarly, the introduction to the *Balance of Payments* declared that:

'Predictions of economic trends any significant way into the future are always hazardous but the balance of payments is notoriously difficult to predict with even approximate accuracy.' Long-term forecasting of the balance of payments tended to be 'at best so hazardous and perhaps, at worst, even misleading'. To anticipate now the long-run future of the balance of payments was considered impossible. Moreover, 'It would not only be pretentious but almost certainly harmful to try.' 34

Projections were considered less hazardous than forecasts.35


35 The difference between forecasts and projections was described in *Projections of the Work-Force* as follows: 'A forecast is a prediction that something will happen. It may or may not be based on explicit assumptions. It is an empirical statement about what the future will
Nevertheless, *Projections of the Work-Force* was littered with warnings, qualifications, provisos, reservations and salvos. In the foreword it was announced that 'the practitioner in this field soon learns humility and makes no particular claim as to the likely correspondence between his efforts to foresee the future and the outcome in reality'. The department maintained that 'there is no getting around the point that, in projecting something subject to so many unknown factors as the work-force, many of the crucial assumptions are essentially based on guesswork and this within a field in which guesses are notoriously prone to go awry'.

Such comments lead one to wonder whether there was much point in preparing projections. The main justification for projections was that 'it is necessary to form approximate ideas about the future potential of output' and that projections were of some use in this regard. The Treasury suggested also that: 'Perhaps the chief value of the exercise is that it makes explicit and discusses the assumptions, with their surrounding uncertainties, on which the arithmetic of the projection is based and essays to give at least a broad indication of the possibilities for the growth of the work-force during the next ten years or so.' The brevity and timidity of the arguments in favour of projections suggested a marked lack of enthusiasm and gives the impression that the Treasury had serious doubts

35 (cont.) hold. A projection, which will most often be used where the factors determining a future event are too complex to permit even a pretence at forecasting, or where some of them are partly or entirely unknown (as in the case of the work-force) is essentially different. A projection is a formal proposition which states that, given specified assumptions, a certain result follows.... a projection says that is a, b, c, ... occur then x results; it does not say that x will occur. A forecast judges that a, b, c ...will occur and that, therefore, x will result (p. 5).’ Emphasis in the original.
as to whether the usefulness of projections could possibly match the effort of preparing them. It suggests also that the creation of the Financial and Economic Surveys Division was indeed essentially a defensive reflex action. It seems ironic that an institution concerned with long-term trends should be staffed with officers who were inimical not only to any notion of planning but also to the mere calculation of trends beyond the short-term and who went out of their way to emphasise that projections and forecasts were of limited value, indeed potentially misleading and disruptive.

The Treasury's wariness of forecasts and projections did not reflect an anti-empiricist bias. Nor did it necessarily entail a rejection of the possibility of economic 'laws'. Rather, it flowed essentially from a concern about undue and unnecessary commitment, an anxiety about the adverse effects of fitting the economy into a predetermined mould. This can be exemplified by the Treasury's views on GNP growth rates. In Economic Growth the department maintained that 'particular rates of economic growth ... cannot be treated as ends in themselves'. The 'real question' which had to be asked was 'not how the growth rate compares internationally but whether, given the pattern of demand, the output required to meet that demand has failed to grow as fast as it might if all available resources had been used with the highest efficiency'. Such arguments implied that the economy should be seen not as an ever-expanding mechanism needing to be thrust forward at the fastest possible growth rate, or needing to achieve a particular target growth rate, but as a device for satisfying an ever-changing variety of needs. Thus, if community demands were such that resources were used in a particular combination or pattern that yielded a lower rate of growth (as measured by GNP) than another

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combination would have yielded, then so be it. What mattered was not growth rates as such but the satisfaction of ever-changing demands.

Such arguments are of importance in understanding the evolution of Treasury thought in the 1970s. For implicit in this argument was a disdain for purposive action, for governmental action designed to achieve particular goals. It was not difficult to take such arguments a step further and argue, along with Friedman, that what is supposedly natural is best, that a particular level of unemployment should not be aimed for, that unemployment should be left to seek its own inherently determined level.

It is interesting in this respect to note the Treasury's comments on the inflationary problems which were inherent in a situation of continuous full employment. In the *Balance of Payments* the maintenance of a continuous high level of employment was described as having 'the strongest economic, as well as social justification'. But the Treasury continued: 'At the same time, it would be unrealistic to deny that full employment provides an economic continuum in which there is an ever present upward pressure on costs and prices.' The department was keen to point out that a successful full employment policy increased the risk of inflation occurring independently of the state of demand. It argued that excess demand had been the main cause of inflation in the late 1940s and early 1950s but had been much less significant since the mid-1950s. It would seem that the Treasury recognised that the problem of cost inflation highlighted the difficulties of combining individualism and equality - the successful reconciliation of which was an article of faith in the Keynesian model. For the department declared that the problem of domestic cost-price escalation 'is as much social as economic, being one of obtaining 292.
acceptance (in principle and practice) of what is equitable treatment as to income shares among different factors of production and, in the process, different sections of the community'.  

It is doubtful whether the Treasury held out much hope for the common acceptance of particular norms of equity. Subsequent events suggest that it was becoming ever more convinced that, given the problem of cost inflation had its roots in governmental pledges to maintain full employment, the answer was to dispense with such pledges. Interestingly, even in 1965 Peter Samuel could declare that: 'Treasury harbours a number of confirmed Paishs, economists who believe that there are substantial gains to be had by running the economy at relatively low pressure with some excess of registered unemployed over vacant jobs, on average.'  

Another persistent theme of the supplements was the claim that Australia was a flexible and adaptable economy. For example, in the Balance of Payments the Treasury maintained that: 'An economy like Australia with reasonably large and varied resources will seldom lack opportunities for adaptation in whatever direction changing circumstances may require.' There was evident confidence that the Australian economy could meet, indeed had to meet in order to survive, most of the pressures of the market mechanism.

36 Emphasis in the original.

Consistent with this picture of a flexible and adaptable economy, reference was made to the notion that resources should, and most often do, flow to their most productive uses. In *Economic Growth*, for example, it was argued that:

in a growing economy, labour tends to shift from the sectors where the value of its product is lower to those where it is higher, thereby increasing the average value of product per worker over the whole economy. If, meanwhile, these changes encourage the adoption of labour-saving techniques in the sectors losing labour (as is generally the case), the average gain is so much the greater. The value of output will thus be increased most by diverting labour to those industries in which the value of its product [strictly, marginal product, a footnote announced] is greatest (p. 16).

The Treasury was keen to point out that such sectoral shifts were not just 'a matter of theoretical possibilities' but were a demonstrable fact based upon historical trends.

The mechanism which gave expression to changing community demands and which ensured 'flexibility of response' - defined as 'the ability of a soundly based and growing economy to adapt to changes in demand and supply conditions' - was the movement of relative prices. In *Economic Growth*, for example, the point was made that: 'Changes in relative prices ... affect the value of product per worker in different sectors of the economy and, of course, if resources were perfectly mobile, would tend to equalize sectoral product per worker through shifts of labour [from the sectors where the value of its product is lower to those where it is higher].' The importance of relative price movements was evident also in the *Balance of Payments* where it was suggested that export production tended to expand when relative prices rose and it declined, or expanded least, when prices tended downward. The Treasury, continued: 'There are, of course, factors other than relative price movements which enter into production decisions,
particularly in the short-term; but, other things being equal, the broad proposition just stated might be expected to hold.'

Here were the roots of the neoclassical model which was to dominate by the mid-1970s and in which the economy was characterised as a flexible, adaptable, responsive mechanism, a system where economic agents are required to exercise choice, and where relative price movements are of crucial significance in effecting economic change.

Although it is possible to detect a move toward the supply side in all the supplements, this shift was particularly evident in the 1966 supplement, Investment Analysis. The supplement began by announcing that:

The pace and pattern of growth of an economy are greatly influenced not only by the level of capital investment undertaken but also by the way in which that capital is invested. In a fully employed economy capital, like labour, is a scarce commodity (i.e. can be put to a number of alternative uses) and it has to be put to the most effective use if economic growth is to be maximised (p. 5). 38

Such comments provide an interesting contrast to the surveys discussed in Chapter Six in which the primary problem was seen to be one of attempting to ensure that an ever-expanding supply of goods and services match an ever-expanding level of demand. In the supplements, by contrast, the problem was seen to be not only how to secure a steadily rising level of inputs but how to use available inputs in the most efficient manner. 39

38 Emphasis in the original.

39 In the 1957 Survey, however, reference was made to the fact that 'the need to economise resources ... is imposed upon us by our capital problem. Our need for capital is relatively high.... But capital in the amounts we require is not easy to come by and that is an obvious reason for making the utmost of what we get.'
the Treasury put it:

The problem of capital tends to be seen in popular discussion as being one of obtaining enough of it. Certainly, it is a necessary condition of strong economic growth that a sizeable volume of new capital continues to become available. But it is not a sufficient condition: capital can be wasted by being uneconomically employed. If, by contrast, it is employed intelligently and efficiently, any problem of its availability lessens in importance, both because a lesser volume of capital is needed to achieve a given productive result and because experience seems to show that capital tends to be more readily forthcoming the more rigorous and dynamic the economy (p.5).

The Treasury was aware that every society had multiple goals and that economic growth, though important, was only one such goal. It was aware also that a community might choose to increase current consumption at the expense of capital accumulation and that not all capital would be directed to increasing the national product. But whatever the goal, 'in a country like Australia, where domestic capital accumulation is high, the problem of efficient allocation of capital might well be thought to take precedence over any question of further increasing the supply'. The department continued: 'The need for a more equal balance between the two, at least, would appear to be undeniable.'

Such arguments constituted a conscious plea by the Treasury for a change in priorities: the clear suggestion was that it is now time to place efficient resource allocation above the generation of additional resources as the nation's chief goal. In doing so, the supplements constituted a plea for a return to neoclassical preoccupations. Not only was the broad neoclassical question of resource allocation now being stressed but, as the above passages indicate, the supplements were dominated by related concepts such as scarcity and the problem of choice between alternatives, the maximisation of gains and the minimisation of opportunity costs.

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Another interesting feature of Investment Analysis was that it was essentially a plea for the adoption of a more rigorously calculative approach to decision-making in both the private and particularly the public sectors via benefit-cost analysis. The supplement was in effect an exercise in teach-yourself economic rationality. The Treasury claimed that investment appraisal techniques in the private sector were generally inadequate. It quoted with approval the view of the United Kingdom National Economic Development Council, which maintained in 1965 that:

There is much evidence that, although the management of most firms undoubtedly take their investment decisions only after careful consideration of the likely costs and benefits as they see them, these decisions are too often reached in ways which are unlikely to produce the pattern and/or level of investment most favourable to economic growth - or even most profitable to the firm (p. 26).

The Treasury, like the Council, was critical of investment decisions based on criteria such as the pay-back period, the average rate of return on average capital, and the total return per dollar of outlay. All these techniques were considered unsatisfactory because they failed to make proper allowance for the effect of time. If the allocation of capital between various alternative uses was to be made more efficient not only would the time factor have to be removed but, linked with this, the risk and uncertainty involved in investment appraisal would have to be 'taken into account', 'assessed', 'weighed up'. Assessment of risk would necessarily involve 'informal procedures'. The former was best served by linear programming, programme evaluation and review technique and, particularly, discounted cash-flow technique.

Despite the inadequacy of its techniques of investment evaluation, the Treasury claimed that decision-making in the private sector was inherently more rational - in the sense that it produced more efficient
results - than that in the public sector. This was because the private sector employed discernible (if inadequate) criteria in decision-making and because the operation of more or less competitive market forces served to discipline decision-makers. In the public sector, by contrast, there was a much greater possibility of investment occurring in unproductive projects mainly because, so the Treasury argued in 1964 in Economic Growth, 'it is difficult to apply the normal price mechanism to the products of such works, so that the criteria for judging their relative economic merits do not exist or exist only in rudimentary form'.

In order to avoid wasting resources, the argument continued, it was essential to employ techniques for assessing public investment decisions 'against proper economic criteria'. There was a danger that public capital be identified mistakenly as a sort of free good. Public capital investment was in fact just the same as private capital investment in that it made demands on scarce real resources and it was imperative therefore to attempt to allocate it as rationally as possible. An important and useful technique which would ensure a greater degree of economic rationality in decision-making in the public sector was benefit-cost analysis. The Treasury was anxious that this technique be adopted widely.

In the discussion of resources and their allocation appended to the 1967 Survey the Treasury stressed that decision-making, particularly in the public sector, should be more rigorously calculative. It was essential that decision-makers 'consider whether, when the costs and benefits have been weighed up, some more economically productive use for the resources in question is not to be preferred'. Alternatives had to be taken into account. It was essential to attempt to count the opportunity cost of the
use of particular resources, to attempt to calculate 'the economic return that would have obtained had the resources been put to their most productive alternative use'. Only then would it be possible to achieve some sort of efficiency in the allocation of resources.

In summary, underpinning the Treasury's analysis was a particular ideal-type which was in harmony with Marshall: that rational man is, or should be, a calculating, deliberating creature who takes a rigorous approach to decision-making, in the sense that he carefully, consciously and systematically weighs up the costs and benefits of each particular situation, considers alternative uses (opportunity costs), makes allowances for time-phasing (and thereby attempts to take into consideration risk and uncertainty), and aims always to maximise his gains. This ideal-type was the counterpart of the flexible, adaptable economy discussed earlier. For only if man exhibits the characteristics listed above can the notion of a responsive economy tending to allocate resources efficiently be achieved.

The section on resources and their allocation in the 1967 Survey was written with the aim of redressing what was considered an undue and misleading emphasis on aggregate demand. Taking the existence of resource scarcity as an unquestioned fact, the department complained that concentration on the level of aggregate demand 'tends to distract attention' from the question of how to put resources to their best use. The Treasury's discussion was a conscious effort to turn attention toward the supply side and it provided a simplistic outline of Marshallian economics, arguing that the problem of resource allocation was 'basically one of choice' involving opportunity costs. It argued further that the movement of relative prices tended to eliminate imbalances between supply
and demand but pointed out that insufficient competition in the economy hampered the allocative mechanism.

An interesting feature of the Treasury's discussion were its comments on resource allocation between the public and private sectors. It seems clear that the section was written as a preparatory statement for McMahon's comments on the public/private sector imbalance in the 1967 budget speech. The Treasury declared: 'What the public sector takes the private sector cannot have.' Further, 'Any reduction in the proportion of resources going to the private sector must to some degree tend to slow down the growth of its productive capacity.' If the growth of its productive capacity was retarded then the rate of increase in its output must also be retarded which in turn 'must affect to some degree the community's capacity to devote additional resources to community services, national security and other public sector activities'. Here again was evidence that there was a growing belief in the Treasury that increased public sector expenditure tended to have deleterious consequences because it cramped the activities, initiatives and financial resources of businessmen. The lesson drawn was that public sector expenditure needed to be kept within strict limits and some supposed balance be maintained between the public and private sectors.

Another interesting feature of the Treasury's discussion was that it returned to a theme pursued in the first three surveys: the allocation of resources between consumption and investment and the need to increase savings. The underlying assumption was that savings determined investment. As the Treasury put it, '[savings] set the limit to the investment that can be undertaken in real terms without excessive pressure on resources - which, of course, assumes that all available domestic
resources are fully employed.' Again, 'A higher rate of domestic savings will release resources from current use so that any measures that effectively enlarge savings will make a higher level of investment sustainable.' The assumed causal connection was the opposite to the Keynesian model. As Meade has pointed out: 'Keynes' intellectual revolution was to shift economists from thinking normally in terms of a model of reality in which a dog called savings wagged his tail called investment to thinking in terms of a model in which a dog called investment wagged his tail labelled savings.' At this time the Treasury was moving toward thinking along the former lines.

The concluding paragraph of the Treasury's discussion captured the essence of the neoclassical synthesis and the essence of the department's outlook in the period under review:

In the Australian economy most choices affecting the allocation of resources are made through the mechanism of the market. To work effectively this mechanism needs to be free as possible from obstructions to movement. Further than that, the aim must be to have the economy as a whole managed so as to preserve flexibility. Overall, this is in no small way a matter of keeping supply and demand in balance and avoiding the excesses and rigidities that hinder the response on the supply side to the changing pattern of demand (p. 36).

Overriding concern was with the efficient allocation of resources and, as a corollary of this, with ensuring that the economy be flexible and that the market be free from distortions. This was the neoclassical element in the model. The Keynesian element was the belief that the economy had to be managed so as to keep supply and demand in balance. Efficient resource

allocation was held to be dependent upon this management. In short, it appeared that the Treasury was in agreement with Samuelson's argument that Keynesian policy strategies were necessary, and had in fact been so used, for the 'classical truths' to come into their own and assume centre stage.

Explaining the Treasury's Evolving Outlook

It was argued earlier that the Treasury's continued move to the supply side was occasioned in part by the rapid rise in defence expenditure from 1963 onwards and the question of priorities which this raised. As early as 1964, in Economic Growth, the point was made that:

to the extent that resources devoted to defence are provided (as in a fully employed economy they must be) by their diversion from the private sector, not only is private consumption likely to be affected but also the level of fixed investment, both public and private, may be lower than it would otherwise have been, probably with adverse effects upon the rate of growth (p. 19).

The Treasury continued:

Before the Second World War, when unemployment was considerably greater and more widespread than it is today, some increase in defence spending could stimulate economic activity generally and so increase growth; and, in those circumstances, it could not have been said with certainty that resources released from defence production or the armed forces would necessarily be taken up into other productive activities. There are, however, probably no advanced economies of which this is true to any great extent today (p. 19).

The point emerges that it was not defence expenditure as such which highlighted the question of resource allocation but, rather, the fact that the rise in defence expenditure occurred in a situation of full employment. That efficient resource allocation was of interest and importance because of the unique persistence of full employment conditions was a point made repeatedly in the supplements. In the Balance of

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Payments, for example, the Treasury declared:

There is ... a notable difference, which cannot be too strongly stressed, between the pre-war period, when policies for full employment were far from being fully understood, and the post-war period, in which by and large most industrialised countries, including Australia, have maintained full employment with only relatively small cyclical variations from it ... by contrast with the pre-war position ... the post-war situation has generally been (and can be expected to continue to be) one in which labour in particular can only be used in producing one item by diverting it from its present use in producing another (p. 18).

In short, then, the full employment of resources highlighted the problem of scarcity and opportunity cost and this in turn increasingly directed the department's attention toward the supply side.

It would seem also that the Treasury's traditional function of financial management heightened its interest in, and made it receptive to, the importance of allocating resources efficiently. As the department itself declared in 1966 in Investment Analysis:

Just as the traditional budgetary Estimates procedure comprised a process of decision-making by governments, involving in effect problems of allocation within some relatively inelastic financial constraint, so the process of as it is evolving today is increasingly coming to be looked at as involving problems of allocation of a growing total of physical resources so as best to serve national objectives (p. 27). 41

In other words, the traditional role of treasuries - which encompassed getting the best value for money, making the most of available finances, and avoiding all forms of wasteful and profligate spending - blended easily with a desire for putting available goods and services to their best use and eliminating wasteful and inefficient economic activities.

41 Emphasis in the original.
Another factor behind the Treasury's evolving model was the influence of individual personalities. The supplements, as noted, were a product of the Economic and Financial Surveys Division. The head of that division was John Stone. Stone was born in 1929. At the age of twelve he left his home town of Merredin, in outback Western Australia, and moved to Perth with his mother where he attended Perth Modern School. He soon established a reputation for academic brilliance. Robert Pullan recounts that Stone 'was so good at maths that his teacher at Mod despaired of teaching him anything and invited him to take the class'. At the University of Western Australia he obtained first class honours in mathematical physics and in 1951 won a Rhodes Scholarship. For two terms at Oxford he studied nuclear physics and then switched to philosophy, politics and economics, again achieving first class honours. In 1954 he joined the Australian Treasury and was seconded to the British Treasury. He returned briefly to Australia in 1956 and then was appointed senior Treasury representative in London, a post he held from 1957 to 1961. When appointed to the Assistant Secretaryship in 1962 he was only thirty-three. He was to remain in charge of the Financial and Economic Surveys Division until 1966, leaving for Washington in 1967 to become an executive director of the International Monetary Fund and the International Bank for Reconstruction and Development.

Stone was not the only relatively young officer appointed to the second division at this time. Roy Daniel's promotion to Assistant Secretary in 1962 was noted in the previous chapter. In 1963 Roy Cameron

was appointed an Assistant Secretary in GFEP. Though Cameron was slightly older than Stone and Daniel, he was a product of post-war university training. He lectured in economics at Canberra University College from 1949-51, received an M.Ec. from the University of Adelaide in 1951, worked as an economist at the World Bank from 1954 to 1956, gained a doctorate in 1955 from Harvard, and eventually entered the Treasury in 1956, working in GFEP. The third division of the Treasury was dominated by officers a generation younger than Wilson and Randall, such as Bill Cole who was appointed a chief finance officer in the Financial and Economic Surveys Division in December 1962. Cole was born in 1926, graduated from the University of Melbourne with first class honours in Commerce, and entered the Treasury as a research officer in 1952.

If the transition toward neoclassicism involved an increasingly positive interpretation of the economy's internal proclivities, a growing belief that the economy was inherently adaptable and flexible, then the relative youthfulness of Stone, Daniel, Cole and those who comprised the third division was of some significance. For such officers had grown accustomed to a strong, growing, fully employed and generally highly stable economy. To such officers, the depression experience was at best a dim childhood memory. In the Balance of Payments Stone and his fellow authors dismissed the depression experience as being 'no longer relevant' and went on to argue with some impatience that it was possibly because memories of

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43 'Standard Hours and the Basic Wage: An Analysis of Two Aspects of the Work of the Commonwealth Court of Conciliation and Arbitration.'

44 'Inflation in a Dependent Economy: Australia 1945-1955.'

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the depression persisted in some quarters that the economy's basic adaptability was sometimes obscured. This leads to the point that over time it became increasingly easy for such officers to claim (and to convince themselves) that the depression was in fact an aberration, that it did not flow from some inherent defect in the system but was the product of the tamperings of some irrational external force, such as the short-sighted policies of monetary authorities or the excessive borrowing commitments of irresponsible governments. Given such a belief, Keynesian economics was not only irrelevant but incorrect.
A persistent theme of the surveys of 1963-67 was the apparent stability of the economy, the rapid rise in defence spending notwithstanding. A relatively orderly, steady, balanced situation prevailed. The period 1968-73 and beyond was to provide a stark contrast. Internally, inflation and then stagflation became a serious problem, industrial unrest became increasingly more intense, and the stock market was gripped with speculative fever in the wake of a succession of mineral discoveries. Externally, the international monetary framework collapsed following heavy speculative movements against the United States dollar and in 1973 OPEC decided to quadruple oil prices. Moreover, economic instability was combined with an incessant and increasingly more vocal movement expressing dissatisfaction with accepted morals and values. As part of the latter, the notion of economic growth came under attack from environmentalists warning of ecological disaster and from doomsday predictionists claiming imminent resource exhaustion. To the Treasury, the defining characteristics of the economy became disorder, imbalance, instability and collective irrationality.

The central theme of this chapter is that in the face of disorder the Treasury abandoned the remnants of Keynesian meliorism and turned increasingly toward neoclassicism. The events of 1968-73 acted as a catalyst, hastening a trend which had been in evidence for over a decade.¹

¹ The Treasury publications upon which this chapter is based are the annual economic surveys, all of which were published by the Commonwealth Government Printer, Canberra; The Economic Consequences of the National Wage Case Decision, a confidential Treasury paper
Political Developments and Treasury's Fluctuating Fortunes

In 1966 the Menzies era came to an end. After seventeen consecutive years in command of the Liberal-Country Party coalition, Menzies decided to retire and Harold Holt was chosen to succeed him. The apparent political stability enjoyed under Menzies was soon replaced by a leadership battle within the Liberal Party which became particularly intense after Holt's death in the surf at Portsea at the end of 1967. Holt's successor was John Gorton. His Prime Ministership lasted three turbulent years. Gorton attracted criticism for being irresponsible and indiscrete (exemplified by the so-called American Embassy incident and the supposed affair with Ainsley Gotto), for imposing a presidential style of leadership, for being unwilling to take advice, and for surrounding himself only with those who supported his ideas.1 Dissatisfaction with Gorton within his own party quickly became apparent. Early in 1969 a Liberal backbencher, Edward St. John, resigned in protest at Gorton's leadership and articulated his complaints in a book, A Time to Speak, published in the same year. After the government's poor showing in the federal elections at the end of 1969, David Fairbairn, Minister for National Development, refused to serve under Gorton. In March 1971 Malcolm Fraser, Minister for Defence, resigned.


This proved the last straw; Gorton was deposed soon after (he cast the deciding ballot in a tied vote of no-confidence in his leadership). He was replaced by William McMahon. The former Treasurer, however, proved ineffectual in uniting the party and bringing cohesion to the coalition. To the Australian electorate, he lacked charisma and confidence, particularly when contrasted with the Labor leader, Gough Whitlam. Moreover, McMahon presided at a time of rapidly rising costs and prices and of increasing unemployment. His position, and that of his government, became increasingly tenuous. At the end of 1962, after twenty-three years in opposition, the ALP gained victory in the federal elections. Whitlam became Prime Minister.

As noted in Chapter One, Gorton's Prime Ministership was the occasion of the first sustained loss of power by the Treasury. In 1969 and 1970 Gorton rejected Treasury advice that stringent anti-inflationary measures be introduced. Also, amid strong Treasury opposition the Prime Minister introduced legislation to regulate foreign takeovers and sided with John McEwen, Minister for Overseas Trade and leader of the Country Party, to establish the Australian Industries Development Corporation. In 1971 Treasury prestige was regained when McMahon followed the department's advice and introduced a tough deflationary budget. The Treasury, however, had difficulties in persuading the McMahon Government to revalue the dollar in the face of a strong and persistent inflow of capital. When it was finally decided to revalue, a lower figure than that recommended by the department was adopted (the Treasury argued for an effective revaluation against the United States dollar of 8.57 per cent; the compromise reached

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between the Liberals and the Country Party was 6.32 per cent). 3

From the late 1960s onwards not only did the Treasury's fortunes fluctuate but it was subjected to a rapid succession of Treasurers. The department had grown accustomed to enduring relationships with its Treasurers: Chifley occupied the post from 1941 to 1949; Fadden from 1949 to 1958; and Holt from 1958 to 1966. McMahon, however, lasted only until November 1969 when Gorton replaced him with Leslie Bury (who in fact had been a Treasury officer from 1948 to 1951). Bury was removed from the post early in 1971 and was replaced by Billy Snedden. In 1972, with the ALP in power, Frank Crean was appointed Treasurer. Crean lasted two years and was succeeded by Jim Cairns. But before Cairns could present a budget he was replaced by Bill Hayden.

A variety of changes occurred also within the Treasury. Just as the Menzies era ended in 1966 so too did that of Roland Wilson: after fifteen years as secretary, Wilson retired from the Treasury to become Chairman of the Commonwealth Banking Corporation. Richard Randall succeeded him. Maurice O'Donnell, after a two year absence as an executive director of the International Monetary Fund and the International Bank for Reconstruction and Development, was appointed Deputy Secretary.

In November 1966 the Australian Financial Review claimed that Wilson's retirement and Randall's promotion to the secretarship 'had left a gap in the ranks between the experienced old guard and the rising bright

young men of Treasury'. The Review believed, however, that O'Donnell's appointment had now filled the gap. It was convinced that until their retirement Randall and O'Donnell would be able 'to work on the development of a new elite of experienced officers'. But things did not work out that way, partly because of O'Donnell's death following a heart attack in September 1969 and partly because of Randall's personality and administrative style. Wilson's biting sarcasm and caustic comments, his razor-sharp intellect, as Coombs described it, and his unflinching willingness to stand up to Menzies, had entered the realm of Treasury legend. Wilson was proud to describe himself as 'a bastard, but ... a fair-dealing bastard'. Randall provided a stark, to some a disappointing, contrast. Randall's chief claim to fame was adroitness in drafting economic papers and speeches. He possessed a lucid and, by bureaucratic standards, florid prose. But his verbal skills did not match his drafting ability. He was a shy, reticent, reserved man, living in self-imposed isolation, often to be found eating lunch alone in the Treasury cafeteria. Walsh describes Randall as 'a quiet, self-contained man with little inclination to communicate ideas downwards'. Such characteristics,


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though possibly viewed with relief by those whose frailties had been the object of Wilson's scorn, were to create communication problems within the Treasury, particularly after the department's reorganisation in 1969. As noted in Chapter One, the 1969 reorganisation resulted in the creation of three new divisions - Overseas Economic Relations, Financial Institutions, and Defence and Works - and a significant increase in the number of second and third division officers. The need became imperative for effective communication and interaction between the divisions, for co-ordination of their activities, and for the channelling of ideas up and down the hierarchical structure, a need which O'Donnell could have met. 7 With O'Donnell's death, Randall decided to assume personal oversight of GFEP and OER, leaving the other divisions under the two deputy secretaries, John Garrett and Don Craik (neither of whom had much experience in economic policy advice). The result, Walsh pointed out in 1971, was the emergence of a sense of frustration among the younger Treasury economists: 'in recent years the down-the-line policy men, who are a good generation or so behind the top strata in age and sometimes even further removed in economic theory, are never too sure they are being listened to or even heard at the highest levels'. 8 Walsh suggested that the frustration produced by Randall's leadership contributed to the notable trend in the late 1960s for GFEP personnel to move to other positions or to overseas Treasury jobs.

7 The point has often been made that O'Donnell was revered in the Treasury. He has been described as 'the epitome of the "Treasury man": urbane, scholarly and very quick-witted'. 'Bonuses in the Treasury'.

In 1971 any lost esprit de corps in the department was regained, some of the reasons for which have been noted already: Gorton was dropped; the much more receptive McMahon was installed in his place; and Snedden, who proved a willing and uncritical Treasury cipher, was appointed Treasurer. But more significant were the changes which occurred in 1971 in the department's leadership. Randall retired and was replaced by Frederick Wheeler, who had left Treasury in 1952 to take up a position with the International Labor Office in Geneva. In 1960 Wheeler returned to Canberra to become Chairman of the Public Service Board, a post he held until his appointment as Secretary to the Treasury. Wheeler was noted for being brimful of drive and determination; he had acquired a reputation for punctiliousness and aloofness. He was methodical to the point of mechanistic. His passion for work was legendary and his administrative skills were considerable. His years at the Public Service Board showed that he believed firmly in the need for acquiring the cream of university graduates to fill the Public Service and that he was willing to make as much use as possible of their talents. As Peter Samuel noted in 1970, 'He makes good use of the bright young men in the higher areas of the third division, calling them in to talk over their ideas and asking for tentative policy papers which are then put to the responsible people for comment.'

Also in 1971 John Stone returned to the Treasury, having been in Washington since 1967 as an executive director of the IMF and IBRD. Stone was placed in charge of the Revenue, Loans and Investment Division. In November, Wheeler decided to appoint Stone to the new post of Deputy Secretary

9 Samuel, 'Six Men of Power'.
(Economic) who thereby effectively took charge of economic policy. Frank Pryor, head of GFEP, and for many years Stone's senior, resigned in protest. He was replaced by Bill Cole, who had been Director of the Bureau of Transport Economics since 1970 and whose acquaintance with Stone went back to their days in the early 1960s in the Financial and Economic Surveys Division.

In the late 1960s (with 1969 being of particular significance) and early 1970s a series of appointments occurred in the department which brought to power men who, like Stone, were a product of post-war university training and and whose ideas were dominated by the stability, strength and adaptability of the Australian economy. It was these men, and not just Stone, who were responsible for moving the department increasingly toward a neoclassical outlook. The Stone Age is surely a misleading epithet. Stone was not a shepherd in charge of a flock of sheep keen to follow him unquestioningly in whatever direction he led. Table 8.1 shows those officers listed in the various Commonwealth Directories between 1970 and 1979 who were either an Assistant Secretary or First Assistant Secretary in GFEP. It shows also their first degree, where obtained and date of graduation (where available). An interesting feature which emerges is that GFEP was dominated in the 1970s by graduates from the University of Melbourne: nine of the thirteen received their first degree from Melbourne (with six of them graduating between 1949-52). It is interesting also that the two officers who were in charge of GFEP between 1970 and 1979 (Cole and Rye) were from Melbourne (Monaghan has been First Assistant Secretary since January 1979), and that the two present deputy secretaries of the department (Rye and Roy Daniel) were from Melbourne (Daniel graduating in 1949). Boxer, Prowse and McBurney were members of staff in the Economics
Table 8.1: GFEP Second Division Officers, 1970-79

<table>
<thead>
<tr>
<th>Officer</th>
<th>First Degree</th>
<th>Date of Graduation</th>
<th>University</th>
</tr>
</thead>
<tbody>
<tr>
<td>A.H. Boxer</td>
<td>B.A. (Hons.)*</td>
<td>1949</td>
<td>Melbourne</td>
</tr>
<tr>
<td>I. Castles</td>
<td>B.Com.</td>
<td>1956(?)</td>
<td>Melbourne</td>
</tr>
<tr>
<td>R.W. Cole</td>
<td>B.Com. (Hons.)</td>
<td>1951</td>
<td>Melbourne</td>
</tr>
<tr>
<td>H.F. Cruise</td>
<td>B.A. (Hons.)*</td>
<td>1951</td>
<td>Melbourne</td>
</tr>
<tr>
<td>B.W. Fraser</td>
<td>B.A.*</td>
<td>?</td>
<td>UNE</td>
</tr>
<tr>
<td>C.I. Higgins</td>
<td>B.Ec. (Hons.)</td>
<td>1963</td>
<td>ANU</td>
</tr>
<tr>
<td>N.F. Hyden</td>
<td>B.Sc.</td>
<td>1964</td>
<td>Melbourne</td>
</tr>
<tr>
<td>S.S. McBurney</td>
<td>B.Com. (Hons.)</td>
<td>1949</td>
<td>Melbourne</td>
</tr>
<tr>
<td>J.V. Monaghan</td>
<td>B.Ec. (Hons.)</td>
<td>1951</td>
<td>Sydney</td>
</tr>
<tr>
<td>A.R.G. Prowse</td>
<td>B.Com. (Hons.)</td>
<td>1952</td>
<td>Melbourne</td>
</tr>
<tr>
<td>F.C. Pryor</td>
<td>B.A. (Hons.)*</td>
<td>1942(?)</td>
<td>Sydney</td>
</tr>
<tr>
<td>C.R. Rye</td>
<td>B.Com.</td>
<td>1958</td>
<td>Melbourne</td>
</tr>
<tr>
<td>E.M.W. Visbord</td>
<td>B.Com.</td>
<td>1949(?)</td>
<td>Melbourne</td>
</tr>
</tbody>
</table>

Source: Who's in Australia; the Treasury, Submission to the RCAGA, Attachment (c).

Notes: * signifies a major in economics.
# Cruise was designated Assistant Secretary (acting).
Department at Melbourne: Boxer was lecturer then reader; Prowse was lecturer (1958-62); and McBurney senior tutor (1950).

The dominance of Melbourne reflected in part a process of chain migration and in part the attraction to the Treasury of having officers moulded in the Giblin/Copland tradition, that of practical, applied, empirically-oriented economists. Sydney's tradition, by contrast, was much more cold, aloof and academic - the veritable ivory tower syndrome.

It is difficult to judge the influence of Melbourne on the course of Treasury thought. While Giblin and Copland, and in the post-war period, Downing and others, were deeply sympathetic with Keynesian ideas (the General Theory continued to be listed as a prescribed text in Economics B as late as 1975), the Commerce Faculty was also long the home of Marshallian economics in Australia, with the Principles being a revered book. Giblin and Copland effectively severed their relations with the Melbourne Commerce Faculty at the outbreak of war in 1939. Giblin never returned to the university and Copland, though appointed to the new post of

10 Giblin's credo on the role of the economist was as follows: 'The role of the economist in practical matters has generally little to do with economic theory. What they contribute is common-sense judgement based on a fairly objective and complete appreciation of the facts. It is for appreciation of the facts that the economists are required; otherwise their place might as well be filled by classical scholars or natural scientists.' L.F. Giblin, The Growth of a Central Bank: The Development of the Commonwealth Bank of Australia 1924-1945, (Melbourne University Press, Carlton, 1951), p. 262n. Similarly, Giblin claimed in 1943 that Australian economists 'are frequently more practical and realistic than the business man.... They are resented of course by sectional business interests. The word of complaint or abuse is "academic"; but in truth they are the least academic of God's creatures.' L.F. Giblin, 'Reconstruction in Australia', Agenda, Vol. 2, No. 3, August 1943, p. 216.
Truby Williams Professor of Economics in 1944, was occupied with wartime administration in Canberra and then with ambassadorial responsibilities in China and relinquished the post in 1946. Wilfred Prest, who had arrived in Melbourne in 1938 to take up a senior lectureship, succeeded Copland to the position of Truby Williams Professor. He was to remain head of the Department of Economics until 1972 and during this time Marshallian economics exercised a decisive influence. As Polglaze and Soper point out:

[Prest] was always a true disciple of Marshall, believing that 'Economics is the study of mankind in the ordinary business of life', and that established doctrine is constantly in need of reconsideration in the light of changes in social conditions and institutions. His own copy of Marshall's Principles was famous. Lavishly interwoven with scraps of paper covered in tiny pencil script, it was commonly referred to as 'Prest's bible', and his students at one time pretended to believe that he was preparing the 9th edition. But they read their Marshall, and they read the modern works, and learned the importance of finding out the facts of the Australian economy.10

But as will be seen, there were factors more significant than university background which were responsible for the changes in the Treasury's outlook.

Abandonment of Keynesian Meliorism

The escalation in the inflation rate and particularly in wages rates which occurred at the end of the 1960s and which persisted throughout the 1970s, was to have a marked effect on the Treasury's evolving model. Having

increased on average by 2.8 per cent a year from 1959 to 1969, the implicit price deflator of the major components of gross national expenditure rose by 4.2 per cent in 1969-70 and then by 6.6 per cent in 1970-71. Underpinning these movements were relatively rapid wage increases, conspicuous since the mid-1960s. In the decade to 1963-64 the annual increase in average weekly earnings was 4.5 per cent. From 1963-64 to 1966-67 the annual rate of increase rose to 6.1 per cent. As a result of a series of Conciliation and Arbitration Commission decisions and continued high levels of overtime work, average weekly earnings were to rise higher thereafter, reaching 8.9 per cent in 1969-70 and 10.7 per cent in 1970-71. In the latter period the increase reflected in part the Arbitration Commission's decision in December 1970 to raise the national wage by 6 per cent.

By the end of the 1960s there were clear signs in the economy of what the Treasury referred to as 'developing hypertension'. In the labour market this was reflected in the phenomenon known as 'wages drift': the tendency for average weekly earnings to rise more rapidly than average weekly award wages. In March 1965 the differential between average weekly earnings and average award wages was 1.4 per cent. By March 1969 it was 3.1 per cent. It was thus evident that an upward trend in over-award payments had begun, a trend which became more significant in 1969-70 and 1970-71.

Another interesting change which occurred at the end of the 1960s was in the relationship between average weekly earnings and productivity levels. In the decade to 1968-69 the annual rate of increase in average weekly earnings exceeded the annual rise in productivity by an average of

318.
2.9 percentage points. In 1968-69, however, the gap widened to 3.5 percentage points, a sufficiently wide hiatus to elicit Treasury concern. The gap was to widen further.

In 1971 price and wage increases began to be combined with an increase in the unemployment rate. Using seasonally adjusted figures, registered unemployed stood at 43,000 in the December quarter of 1970. At the same time in 1971 the number had reached 87,000. A peak of 114,000 - by far the highest post-war figure at that stage - was attained in the September quarter of 1972.

Initially, the combination of rising unemployment and increasing inflation was considered an aberration, the deteriorating unemployment situation being blamed on the Treasury's inappropriately deflationary budget of 1971 and on the decline in activity associated with the end of the 1969-70 minerals boom. But as the 1970s progressed stagflation came to be looked on increasingly as the norm. It has now persisted for a decade.

Throughout the 1960s the Treasury emphasised the interrelationship of cost and demand influences in explaining inflation. Even in 1971 the department could argue that 'a condition of strong and general demand for labour has usually provided the context in which cost influences do most to raise the wage structure and that has certainly been true of recent years'. In the 1971-72 budget speech Snedden reiterated the point that demand influences underpinned cost movements. In a paper on the National Wage Case decision of December 1970, the Treasury expanded on the causal connections:

the cost and demand influences within the economy ... are very closely linked; in the labour market, for example, a high level of demand for goods and services leads to a situation in which
employers bid up wages in competition for the higher level of
demand ... wage increases raise the costs of industry and at
one and the same time raise the money purchasing power of the
recipients, which in raising total demand increases the
possibilities for passing on higher wage costs in higher prices
(pp. 2-3).

Similar arguments were first advanced in the 1960 Survey.

But as the 1970s progressed the Treasury became less convinced that
a situation of buoyant demand was a necessary condition for cost inflation
to flourish; it was willing to accord cost influences a large degree of
autonomy from demand conditions. Pursuing a line adopted in 1966 in the
supplement on the Balance of Payments, the 1972 Survey argued that 'direct
demand influences tend to be subordinate to cost influences.... By far the
major direct influence upon prices has been found to come from the cost
influence, and particularly changes in unit labour costs.'¹¹ Consistent
with this, the department claimed that excessive wage settlements had
provided the primary stimulus to the increase in inflation over the
previous few years.

The Treasury maintained also that recent wage movements reflected a
fundamental change in the expectations of those engaged in wage
negotiations. The notion of inflationary expectations was first mentioned
in the 1969 Survey but not until 1972 was it considered in any detail.
Obviously influenced by Milton Friedman's critique of the Phillips curve
and his claim that the weakness of the trade-off hypothesis was its failure
to take expectations into account, the 1972 declared that:

Expectations have probably always been a part of the wage

¹¹ Emphasis in the original.
bargaining process, tending to change with the ups and downs of the business cycle. In recent times, however, there may have been a change in expectations of a more far-reaching kind. In particular, expectations may now be reflecting the self-perpetuating and accelerating potentialities of quickened inflation.... It may be, too, that both employers and unions have only recently begun to assess the full implications which a full employment economy holds for the bargaining process. With expectations changing in both these ways, both parties to wage negotiations may approach them in a different frame of mind than heretofore. In that sense, the present context is very different from that of the period from which the data leading to the early Phillips analysis were drawn (p. 24).

Concomitant with the supposed onset of inflationary expectations, a change in the Treasury's policy stance on inflation became obvious. Throughout the 1960s the department remained faithful to the notion of demand management as an effective device for overcoming inflation – this was unsurprising given its belief that demand conditions were either directly or indirectly responsible for inflation. Even with the onset of stagflation the department's faith remained. In 1971 it argued that demand management should not be written off as ineffectual. It recognised that stagflation would lead to demands for new policies to counter inflation. But what new policies could be more effective than traditional methods? The answer did not lie with prices-incomes policies. Attempts to use such policies had proved 'either ineffective or undesirable in terms of longer-run resource allocation'.

But as the 1970s progressed there seemed to be a hardening in the department's ideas on how to deal with inflation. In its discussion of inflationary expectations in the 1969 Survey the Treasury concluded by arguing that: 'Such psychological reactions can hinder the operation of counter-inflationary measures. The importance of timeliness in the dampening of inflationary trends should thus need no emphasis.' In this
the Treasury seemed to be suggesting that inflationary expectations could be prevented by general measures to dampen the inflationary process provided such measures were taken promptly enough. There was an interesting change of attitude, however, in the paper on the National Wage Case decision of 1970. Having argued that the decision would have an unfortunate effect on expectations, the paper declared: 'although the objective elements in the situation must be the prime target of counter measures, it is important also to take steps of a kind which will counter the development of an inflationary psychology in Australia'. The implication was that even if excess demand conditions were removed, and even if the measures were introduced promptly, it might be necessary to continue the policy of deflation in order to eradicate all remnants of an inflationary psychology. As the Treasury confided in the paper:

The longer inflationary trends persist the more entrenched ... expectations become, and the more difficult they are to eradicate. As recent experience overseas has shown, it can require very strong measures indeed - much stronger than would be needed to cope with the objective elements of inflation alone - to make a substantial impact on the rate of increase in prices once such expectations become widely established (p. 3).12

In 1972, in a discussion of whether the Phillips curve was dead, the Treasury argued that 'it has long been generally accepted that high levels of demand relative to resource availability - particularly when prolonged - will bring about high rates of wage increase, and probably few would argue against the proposition that the inverse relationship still holds for low rates of unemployment'. It therefore followed 'that excess

12 Emphasis added.
demand must be removed before policies of any sort can become effective in combatting the ensuing inflation'. The clear suggestion was that inflation could not be combated by demand management alone. Demand management policies, though important, were merely a preliminary step. Thus,

the fact that, once an accelerating wage-price trend has become established, the removal of excess demand does not lead to an early significant slackening in the rate of wage and price increases does not imply that, in the absence of action to remove excess demand, the wage-price trend would not have gone on accelerating. The substitution of a high but relatively constant rate of inflation for such an accelerating trend will not be all that is desirable, but it will be a worthwhile advance in its own right (p. 23).

Thus, as a corollary of the belief that inflation now required much stronger measures 'than would be needed to cope with the objective elements of inflation alone', the Treasury was arguing that deflationary policies should continue to be pursued even if the inflation rate appeared merely to stabilise rather than decline. Such a belief is of obvious significance in understanding the department's insistent plea since the mid-1970s that deflationary policies be pursued despite the maintenance of unprecedented post-war levels of unemployment). It would justify its policy stance by pointing to the fact that the accelerating trend of inflation of the Whitlam years has been halted. It would argue further that such policies have to be maintained in order to quell inflationary expectations.

In 1974 the Treasury took these arguments to their logical conclusion by urging the adoption of its now-famous 'short, sharp shock' strategy. The essence of the strategy was that a pool of unemployed be

13 Emphasis in the original.
created so as to dampen inflationary expectations and excessive wage
demands. The strategy was first propounded at a meeting with the Labor
Cabinet shortly after the elections of May 1974. The events of the meeting
have been described by John Edwards:

Sir Frederick Wheeler, Secretary to the Treasury and his deputy
Mr John Stone told Cabinet ... that unless at least another
100,000 Australians lost their jobs and were compelled to live
on social service benefits, inflation would accelerate and
perhaps become unworkable. It was, they acknowledged, a hard
decision for any government to make, but nonetheless one that
had to be made. Sir Frederick and Mr Stone could see it as the
only alternative, that all this talk of union co-operation was
just so much hot air, and that unless the Government gave the
economy a short, sharp shock, Treasury could not rule out the
possibility that accelerating inflation would become hyper-
inflation, and in the panic that followed Australia's social
institutions would collapse.14

The proposed strategy entailed the introduction of a mini-budget which
would include increases in income tax, a 10 per cent rise in petrol excise,
an increase in tobacco and spirits excise, higher company taxes and
increased charges for postal and telephone services. This was to be
coupled with a tight monetary policy.

These changes reflected a pessimistic shift in the Treasury's
social philosophy. There was less scope for reliance on trust and
persuasion, on co-operation and the autonomous exercise of self-
discipline. Individuals were now seen as self-centred and acquisitive.

14 John Edwards, 'Treasury Barons Under Siege', National Times, 9-14
September 1974. At a meeting with senior Ministers in July 1974
Wheeler admitted that the short sharp shock strategy might entail an
increase in unemployment of about 180,000. See John Edwards, 'In 7
Momentous Months Whitlam Turned to Refloating a Sinking Ship',
National Times, 18-23 November 1974. On the strategy, see also Barry
Hughes, Exit Full Employment: Economic Policy in the Stone Age,
(Angus & Robertson, Sydney, 1980), Ch. 7.
Thus, discipline must be imposed externally by the creation of unemployment. The short, sharp shock strategy, as such, represented the break-down of the optimistic, meliorist, progressive view of human nature central to the Keynesian model. It represented also the disbandment of the notion that it was the government's responsibility to provide a safe, secure environment in which the maintenance of full employment was guaranteed. Full employment and other protective pledges had created indiscipline, complacency and weaknesses on the part of economic agents. A stronger, more efficient economy required that such pledges be done away with.

The Treasury's references to the vague, amorphous concept of inflationary expectations clouded the subtle intellectual shifts which were occurring in the department at the turn of the decade. It would clearly be superficial to claim that the onset of such expectations led the Treasury to abandon Keynesian meliorism. The notion of inflationary expectations suggests little more than that if inflation persists, economic agents come to expect that it will continue and plan their behaviour accordingly, so that, for instance, they will make allowance for probable inflationary tendencies when they negotiate wage settlements. Using the pursuit of individual self-interest as the criterion, inflationary expectations were seen as an instance of rational behaviour, at least with respect to the short-term. The Treasury explicitly acknowledged this in the 1972 Survey. But it continued:

In the longer-run, relative income shares tend broadly to return to proportions determined by structural features of the economy. Both the short-run general gains (and any longer-run particular gains) are made at the expense of the weak - the pensioners, unorganised wage-earners, rural workers and so on - who must wait for special action to restore their position. If, in the necessary process of combating the inflation that
results, growth has to be sacrificed in some degree, then nearly all may be worse off (p. 25).

Two points of interest emerge. First, the idea that there is a long-run tendency for relative income shares to return to a particular pre-set proportion reveals a mechanistic outlook akin to the neoclassical idea of a self-righting system tending inexorably toward general equilibrium. Second, and more important, the image being projected was that of the strong prevailing over the weak, the organised prevailing over the unorganised. Snedden used the same image in the 1971-72 budget speech: 'There is scope for a real lift in the standard of living which should be shared by many who would otherwise be the undefended victims of inflation and the self-seeking of stronger, more aggressive groups.'¹⁵ What the Treasury found new and worrisome about wage negotiations over recent years was not some supposed change in expectations but the increased militancy of trade unions, the desire of unions to use their power much more than previously to their own advantage. It was the trade union movement which constituted the strong, the organised and the aggressive. And it was a perceived change in their attitudes which hastened the abandonment of Keynesian meliorism.

In a revealing passage in the 1971 Survey the Treasury made clear the change in the attitude of trade unions to wage claims:

These indicate a hardening disposition to obtain greater improvements in money wages and working conditions. There is amongst broad sectors of the work-force a greater readiness to press claims to the limit, less readiness to accept delay in the settlement of claims and a considerable speed-up in the cycle of the claim, settlement and new claim. These new

attitudes have found reflection in rising industrial unrest which, in terms of working days lost, has more than trebled in the three years to 1970 (p. 23).

Similarly, Snedden claimed in the 1971-72 budget speech that 'there has been and still is a powerful upthrust of costs, stemming largely though not wholly from large wage claims relentlessly pursued'. He referred to 'the escalating level of industrial unrest', the 'rising tide of militancy', the 'confrontations in industry [which] are often resolved only at the cost of grossly inflationary wage settlements'. He pointed out that during the previous three years annual working days lost through industrial disputes had been 1.1 million, 2 million and 2.4 million. The number of days lost in the first five months of 1971 was some 25 per cent higher than in the same period in 1970.

One can see in other industrialised countries a growing concern in the early 1970s with increased militancy on the part of trade unions. It is interesting in this respect to consider Mishan's 1974 article on what he described as 'the new inflation'. Mishan claimed that 'successive governments, in their monomaniac pursuit of economic growth, have sown the seeds of discontent among their peoples and are now reaping a bitter harvest', and continued: 'The unabating struggle for "more" between the unions (white-collar no less than blue-collar) has become more defiant over the last several years.' Policies designed to hasten the rate of growth

16 Ibid., p. 39; emphasis added.
17 Ibid., p. 49.
had set in motion an intense distributional struggle: 'The inevitable consequence of these growth-inspired developments has been to engender a quite unprecedented hypersensitivity among occupational groups throughout the country on the issue of their share of the national pie - or, more exactly, of the increase in their members' earnings as compared with the increase in the earnings of members in other occupations.'\(^{19}\) Again, 'the quickening response of the public to years of unabating growth mania has brought us to the frantic state in which we can scarcely digest our allotted slice of the pie for glowering at the slices being eaten by others'.\(^{20}\)

It is interesting to compare Mishan's views with those of Roland Wilson, as put forward in an address in 1968 to the Australian-American Association. Wilson pointed out that the dream provoked by World War II, that '[t]he shackles were to be struck off the unfree, colonialism was to give way to free and equal opportunity for all peoples, war was to give place to economic development, [and] poverty was to give place to plenty', had failed to materialise. In explaining why, Wilson suggested that American leadership had possibly been too successful: 'If you teach and help people to be more independent, and to stand on their own feet, they soon get to the position where they resent leadership of others.' Another factor was the discovery in the world's richest country of vast inequalities of wealth, welfare and opportunities between white and black. The negro was rebelling against this. He 'has thrust his way

\(^{19}\) Ibid., p. 15.

\(^{20}\) Ibid., p. 16.
forward and can no longer be regarded as a mere black appendage to a predominantly white population'. More fundamentally, technological, scientific and organisational changes in the post-war period had produced nothing short of a revolutionary change in life-styles and this brought with it 'the questioning of traditional values, and the crumbling of established social foundations'. The affluent society had become a reality: 'Is it surprising that all want to share in it - and not to bother too much about how far they have contributed to it?'21 There is here some similarity to Mishan's arguments in that the underlying theme was that the material prosperity of the post-war period brought about by economic growth had created among social groups a heightened interest in, and an increased determination to seek, greater access to employment, educational and other opportunities viz-à-viz each other.

In 1976 Wilson moved very close to Mishan's position. Referring to the rapid increase in material prosperity in the 1950s and 1960s, he claimed that 'a new world of plenty was opening up', bringing with it 'a greatly enhanced interest in how the fruits of progress were to be shared', and continued:

At the Government level there was renewed if not spectacular interest in ideas of social welfare. At the industrial level there was a strengthening of the muscle of the trade unions and a corresponding weakening on the side of employers both of the power and the will to resist. With more than enough to be shared, why haggle over trifles? Over-award payments began to be the norm, and collective bargaining to over-shadow the old processes of conciliation and arbitration. The muscle began to

21 Roland Wilson, 'Friendship Without Tears', address to the Australian-American Association (Victorian Branch), Melbourne, Thanksgiving Day, November 1968, mimeo.
be used with increasing freedom and effect. 22

In short, the notion of inflationary expectations disguised what was of real concern to the Treasury, this being the heightened avariciousness and militancy of economic agents. The persistently high and ever-increasing inflation rate was a measure of this tendency and of its virulence.

It is interesting that in both 1971 and 1972 the Treasury rejected the idea that the heightened domestic inflation rate reflected overseas influences. The 1971 Survey declared that: 'The old notion of inflation being exported from one country to another through export or import prices [sic] increases just does not fit the facts of this situation.' Such arguments were important in the determination of causation. The implication was that Australians had only themselves to blame for the current inflationary problems; it was home-grown avariciousness that was at fault. As the 1971 Survey concluded: 'our inflationary problem has in the main had its origins here and has gained its impetus from home sources'.

For those looking for it, it seemed also that there had recently been a heightened desire to make quick and easy monetary gains without any corresponding increase in effort and individual exertion. This could be seen in Australia in the intense speculative boom which prevailed in 1969 and 1970 in which investors competed furiously to make profits out of dubious mining companies such as Poseidon, Narbarlek and Tasminex. The

desire for easy gains could be seen also in the international currency speculation at the end of the 1960s and into the early 1970s. Australia felt this speculation directly, with portfolio investment rising from just under 14 per cent of total overseas investment in 1960-61 to 1964-65 to 34 per cent in 1965-66-1968-69, and still higher thereafter.

What troubled the Treasury more than the apparent greed of economic agents was that they had violated accepted norms of behaviour, they were unwilling to conform to what was 'right and proper'. In the domestic sphere the rapid rise in public sector expenditure during the 1960s had violated the supposedly 'proper' relationship between the public and private sectors, causing imbalances. In the international sphere the Treasury suggested in 1973 that 'the decline of the Bretton Woods system was to a significant degree due to the failure of some of its more important members [the United States and Great Britain] to accept the rules of the game', these being that some sort of exchange rate flexibility be shown in the face of persistent balance of international payments disequilibrium.

It seemed that discipline had been abandoned. Gorton's unwillingness to listen to the Treasury in 1969 and 1970, and his determination to increase government expenditure at a relatively high rate in the face of burgeoning inflationary figures, exemplified this. Commenting on the 1969-70 budget, Maurice O'Donnell declared sardonically: 'Well, if you inflate hard enough you can always inflate your way into a health anti-inflationary-looking Budget surplus.'

23 Quoted in 'Bonuses in the Treasury'.

331.
Governmental indiscipline was manifested again in 1972 when Snedden resorted to budget largesse in a vain attempt to win electoral support. To the Treasury, Whitlam's budgetary policies were merely the continuation of an all too obvious trend.

It seemed also, so Wilson maintained in 1976, that everyone had become 'softer':

Of recent times there has been plenty to suggest that we have become softer and more pliant. Many of the older virtues have been sloughed off like an old skin, and the new skins are not always pretty to behold. Revolt against old ideas, older forms of education, older disciplines and older moralities have become endemic, and only too often revolt seems to have no end but in itself. 24

It was essential that discipline, both at the individual and collective level, be re-established and that a greater degree of 'bottom', to use Wilson's phrase, be developed. By 'bottom' Wilson meant such characteristics as 'capacity for fortitude, self-reliance, stability, courage, coolness and solidity'. 25 The Treasury shared Wilson's sentiments. In the concluding section of the 1972 Survey the department declared:

An appropriate economic policy is a necessary condition for strong economic growth but it is not a sufficient condition. Productive effort can be below potential because there is insufficient demand to call it forth. In that case, changes in policy will be appropriate and will certainly be made. But productive effort can also be below potential for other reasons. The 'darg' mentality still permeates industrial attitudes in many areas of industry - just as, on the other side of the labour-management fence the quality of management

25 Ibid.
often leaves much to be desired. Pressure for fewer working hours is much in evidence currently. So, for that matter, is resistance to moves for an increasingly competitive economic environment. All these manifestations work against economic growth and the raising of material living standards (p. 41).

The Treasury's distaste for the 'darg' mentality, the notion of working a set number of hours or of producing a fixed output and doing no more, is evident. It would seem that in the department's ideal-type economy economic agents were, to use some of the words used in the supplements to describe the sort of economy Australia should aim for, 'robust', 'resilient', 'vigorous', 'dynamic', 'practical', 'sound', and 'aggressive'. Such agents welcomed, indeed thrived on, a competitive environment. Fired by self-interest they were willing to work overtime, to push themselves harder according to the situation. Given such an ideal-type, the darg mentality and the pressure for less working hours and increased protection are anathema.

The Treasury continued its discussion of the notion of productive effort by arguing that:

Of course, if it were accepted that limitations on productive effort and moves towards increased leisure involved a taking out of productivity gains in that way rather than increasing real income, then the issue would resolve itself into a straight choice between different value judgements. It is, however, hard to see much evidence of an acceptance of, or even a facing up to, the hard choice that is involved. That choice is, very simply, that the fruits of increased productivity cannot be garnered twice, once in increased real income and again in decreased productive effort or increased leisure. To change the metaphor, it is the old question of having one's cake and eating it too (p. 41).

The message was that as a result of a productivity increase it was possible to have either an increase in real wages or in leisure but not in both. The Treasury seemed to favour the choice of real wages. But whatever choice was made, the point was that a choice did have to be made. This was
the essence of economic life. It was the department's belief that economic agents should face up to and accept this fact; that they should taken into consideration and adapt to economic 'realities'; and that they should be willing to make 'hard choices'.

As a corollary of this ideal, most governmental activities in the economy were viewed with disapproval. For the government, the public sector, failed to possess any of these characteristics. Not only did the government lack economic rationality but the public sector 'crowded out', indeed obscured, the private sector by upsetting the calculations of businessmen, by distorting price signals and by creating dependencies - the latter by protection policies, by handouts and by constraining competition.

It is clear that the Treasury's disdain for the darg mentality, its criticisms of an apparent tendency toward slackness, softness and inefficiency, and its distaste for those looking for soft options, for some way of avoiding hard decisions, was a reflection in part of the department's own self-image, a projection of the notion of the 'good Treasury man'. Stone, for example, is renowned for his tenacity, competitiveness and doggedness and the story has become legendary of how, after a bet, he set off one wintry evening and ran the thirty kilometres to Lake George, arriving around 4 a.m.\(^{26}\) It has been suggested that such characteristics were partly a product of Stone's students days at Perth Modern, entrance to which was only through scholarships or competitive examination and which thereby, according to Robert Pullan, 'fostered a

\(^{26}\) Stone was a sportsman of some note, representing Western Australia in hockey in 1948 and 1949.
certain intellectual arrogance'. 27 Stone was a model of conscientiousness. One fellow student, Max Walters, remembers that on the journey to school, 'while everyone else was ogling the girls, John Stone would be sitting reading a book on algebra'. 28 Another student, Lloyd Zampatti, described Stone as being 'immensely brilliant', 'in a class by himself'. 29 At university Stone was elected to the Guild Presidency and later won a Rhodes scholarship. It was apparent early that he was a man of ambition and determination, driven by a relentless will to succeed.

In his reliance on individual effort and resourcefulness and academic prowess, Stone was notably similar to Roland Wilson. Both came from small isolated towns (Wilson was born in Ulverstone, Tasmania); both achieved distinction for academic brilliance at an early age (Wilson topped the Tasmanian Leaving Certificate examination); both won Rhodes Scholarships; both had impressive university qualifications. 30 Randall, too, thought not as brilliant as Wilson and Stone, was the epitome of individual effort and enterprise. It was recounted in Chapter Six that he left school early, struggled through the depression years as a woolsorter, matriculated while working part-time and eventually graduated at the age of thirty with first class honours in Economics. Wheeler, similarly, left school at the age of fifteen, became a clerk in the State Savings Bank,


28 Quoted in ibid., p. 25.

29 Quoted in ibid., p. 28.

30 The best biography on Wilson is by John Hetherington, Uncommon Men, pp. 184-92.
moved into the loan arrears department in 1931, studied part-time at Melbourne University, eventually gaining a diploma in Commerce in 1935 and the full degree in 1938, and then moved to Canberra to aid Copland in the Prices Commission.\textsuperscript{31} Wheeler's devotion to work, as noted, was legendary. At the Public Service Board he regularly called informal meetings (in addition to the day-time Board meetings) which often continued throughout the evening. There is a famous story of the PSB officer who anxiously looked at his watch around midnight during one of these meetings, only to be asked by Wheeler whether he had another appointment.

The Treasury as a whole has acquired a reputation for diligence and perseverance. O'Donnell was said to have worked himself to a premature death. Frank Pryor, for many years head of GFEP, has been described by Bruce Juddery as 'furiously hard-working'. Such an institution had little time for those who were anxious for quick and easy gains, who lacked self-discipline, who were keen to reduce their working week, who shunned competition and who were unwilling to stand on their own feet.

\textbf{Locating the Source of Instability}

In addition to denouncing the increasing laziness and avariciousness of Australians, the Treasury responded to the disorder and instability of the late 1960s and the 1970s by pointing to the inherent beneficence of market forces if they were allowed to operate unhindered. Both Treasury Economic Paper No. 1 and No. 2 waxed eloquently on the order, harmony and

\textsuperscript{31} Tony Thomas, 'Man in the Eye of a Storm', \textit{The Age}, 30 May 1975.
responsiveness of the market mechanism.

A central theme of TEP No. 2 was that those who attacked growth were foolishly attacking the wrong subject. For growth was not an independent phenomenon but a reaction to, a result of, aggregated individual decisions and demands. The department was convinced that problems commonly attributed to growth were in fact manifestations of a failure to allow market forces to operate. Such problems were not intrinsic to the growth process at all. Excessive environmental pollution was an example. The department argued that pollution problems arose because no charge was usually imposed on the use of environmental resources such as air, rivers, lakes, oceans and landscapes. It declared: 'Any resource will be grossly over-used if its use is unrestricted and no charge is made for it.' The solution was obvious: it was not to restrain the rate of growth but to equate the private costs of a particular decision with the social costs, 'to change the conditions under which producers and consumers are allowed free and unrestrictive use of the "shared resources" of the environment'. The best way to do this, following Pigou, was to alter the price structure, and hence the signals provided to economic agents, by levying taxes or imposing licences. The 'polluter pays' principle was considered preferable to the 'public pays' principle.

In both TEPs there was evident confidence in the speedy and efficient operation of the market mechanism, an unbounded faith in the economy's capacity for adaptability and for continuous technological

32 In the original this passage was emphasised.
Numerous examples can be given of this confidence, such as the following from TEP No. 2:

In a real sense, technical progress 'creates' resources, so that the faster and further growth continues, the greater the availability of resources (at a given real cost) will be (p. 6).

It is difficult to forecast what the consequences of exhausting particular resources would be. For any particular mineral it would happen only gradually, by a process which involved a steady rise in price. Presumably patterns of production and consumption would gradually adapt towards what they would have been had the mineral never existed in the first place. Moreover, developments in substitute materials and processes and in the pattern of demand can mean that an 'indispensable' mineral at one time might become redundant at another (p. 33n).

It is of the very essence of technological change that alternative methods or substitute products are invariably available in the longer-term (p. 34).

This process of substitution and expansion in the range of alternate materials, sources and processes is going on all the time (p. 35).

If scarcities begin to develop, all past experience suggests that revolutionary new approaches would become practicable (p. 36).

Technological advance has become virtually continuous, each improvement creating new opportunities for further advance (p. 39).

For a critique of such views, see N.G. Butlin, 'From Golden Ages to Doom: A Critique of the Treasury's Paper on Growth', Bank of New South Wales Review, No. 8, September 1973. For a particularly insightful discussion of TEP No. 1, see E.A. Russell, 'Foreign Investment Policy - What Role for the Economist?', 1972 Presidential Address to Section 24 of ANZAS. Reprinted in Australian Economic Papers, Vol. 17, December 1978. Russell points out that: 'The basic confidence of the Treasury Paper is the efficacy and speed of working of the market mechanism (p. 198),' and goes on to support a fundamental tenet of this thesis: that disputes between economists do not arise simply over questions of fact but more fundamentally because of different interpretations of facts. The Treasury could not accept this, ridiculing those who offered alternative scenarios as basing their ideas on mere 'assumptions'.

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The Treasury's faith in the adaptability of the market economy derived ultimately from its view of human nature, in particular its belief that people wanted to make 'right' decisions, these being those which ultimately 'give them what they want'. The department was convinced that economic agents were essentially rational, in the sense that they were carefully calculative. Decisions were made on the basis of probable costs and returns. Expanding on this, it was claimed that:

The returns may, of course, be of many kinds and may include altruistic considerations as well as [a] range of other non-material values.... Decisions may also be influenced by the circumstance - increasingly present in the case of the well-to-do - of not having to weigh up too carefully the pros and cons, especially on minor matters. Even those on modest incomes make many decisions, out of habit or otherwise, with little or no conscious consideration of how to get the most for their money. Nevertheless, the process involved in reaching any rational decision is essentially a benefit/cost calculus; and although the reasoning process is expressed in many different ways, it tends to become increasingly conscious and articulated as decisions become more important (p. 26n).

Here was the ghost of Marshall: decisions seemingly made out of habit are in fact the result of previous cost-benefit analysis.

The point emerges that the Treasury saw neither the system nor the individual at fault. It blamed instability on the force of collective interference - such as imposed by governments, trade unions, monopolistic and oligopolistic producers and sellers (OPEC being a good example of the latter). This force was outside the system.

Conclusion

The fact that the neoclassical synthesis flourished during the 1950s and into the first half of the 1960s was a reflection and a symbol of the degree of social cohesion which prevailed at that time. The synthesis, by
definition, was a symbol of accord. It was supposedly a reconciliation of Keynesian and neoclassical analysis. It was a truce, a commonly accepted set of principles, 'truths', under which economists could pursue their scientific endeavours, could produce hard facts, and avoid silly ideological differences. The synthesis signified harmony. As Samuelson proudly declared in 1955 when he first unveiled the synthesis: 'In recent years 90 per cent of American economists have stopped being "Keynesian economists" or "anti-Keynesian economists". Instead they have worked toward a synthesis of whatever is valuable in older economics and in modern theories of income determination.' Samuelson claimed that the synthesis 'is accepted in its broad outlines by all but about 5 per cent of extreme left-wing and right-wing writers'.

The period 1968-73, by contrast, was marked by an increasing trend toward polarisation in economics and other social sciences and again this was in part a reflection of changes in the social scene. It reflected the rejection of traditional values, the scorn for established notions of authority, the rise of the so-called 'counter-culture', the rise of the Women's Liberation movement, and the deep divisions caused by the Vietnam War. It was testimony to the extent of social unrest at that time that the economics discipline witnessed both a move toward a more conservative stance (the neoclassical resurgence, the monetarist counter-revolution, as Johnson described it in 1971, supply-side economics) and a revitalised

interest in radical economics. The post-Keynesian school also became much more vocal during this period and established its own journal.

The Treasury moved increasingly toward economic conservatism and openly embraced the neoclassical resurgence. Within the Treasury (and indeed within mainstream economics) this change did not occur as quickly as has often been assumed. The Treasury had long believed that continuous full employment created problems of incessant wage demands. In addition, as early as 1956 the Treasury could refer to 'the tendency to slackness, inefficiency and indiscipline on the part of people - by no means all confined to wage earners - who are prone to trade upon the security which full employment has brought'. The Treasury had long recognised the need to increase savings and had long believed that savings determined investment. The Treasury, in short, had been steadily moving toward the supply side since the end of the 1950s.

What made neoclassical economics particularly appealing to the Treasury was its underlying call for order, discipline and stability. A point emerging from Mishan's article was that the corollary of the increased power of unions was the increased impotence of governments. Mishan claimed that 'these growth-inspired developments have ... in the last few years ... combined to provide organised labour with a will and power to thwart the operation of traditional economic nostrums'. Again, 'A pattern of union militancy is emerging which threatens to be independent of demand conditions.... fiscal policy alone may be of no avail.' It is

37 Ibid., p. 17.
clear that the Treasury was also growing ever more concerned at the seeming impotence of governments. The short, sharp shock represented an anxious attempt to re-establish discipline and to reassert control via indirect methods, via a slow and determined process of beating wayward elements into submission. The idea was that no longer would economic agents be able to shelter under the protective wing of government. Economic agents would be forced to pay much greater heed to market forces, to respect them and be subservient to them. Eventually, order would be regained. Governments may have become increasingly impotent but the market mechanism had not. It was the ultimate disciplinary force.
Chapter Nine: Discipline, Flexibility, Governmental Impotence: 1974-79

Whereas the Treasury model which prevailed throughout the 1960s is best described as a neoclassical synthesis because of its opinions on the need for, and efficacy of, demand management, the model in the period under review was much closer to fully-fledged neoclassicism. The Treasury of the mid-1970s agreed with earlier views that demand pressures were significant in explaining inflation. It did not accept, however, the other side of the Keynesian coin: that unemployment was fundamentally a result of insufficient demand. It explained unemployment mainly in terms of excessive real wages and in this sense its outlook was decidedly neoclassical. It believed that the rise in unemployment from 1974 onwards would have occurred regardless of the recession that commenced at that time. Linked with this, it believed that expansionary policies would not relieve unemployment; they would serve only to increase it. The prevailing assumption was that there was no trade-off between inflation and unemployment; instead, more inflation simply led to more unemployment.

Within the economics profession as a whole it is possible to discern a similar trend toward neoclassicism during the 1970s and indeed earlier. The marked rise in popularity of monetarism and rational expectations theory is evidence of this. Moreover, the neoclassical resurgence was part of a broader and undeniably important political trend toward neoconservatism. Neoconservatism came into vogue in a variety of industrialised nations, such as Great Britain, the United States and Australia, during the 1970s. In Australia, despite predictably bitter criticism of Fraserism by the ALP, there was evident agreement between the major political parties by the mid-1970s that Keynesianism was no longer relevant. In 1976 Phillip Lynch, the Liberal Treasurer, declared:

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To some, cutting back on government spending and the deficit seems paradoxical; we hear it argued that that will not contribute to economic recovery but, on the contrary, will simply serve to depress activity still further. In today's world that orthodox 'keynesianism', in my judgement and in the judgement of the Government, is no longer appropriate; on the contrary, it is hopelessly outdated.1

Lynch was merely repeating the views of the Labor Treasurer, Bill Hayden, who declared in the 1975-76 budget speech: 'We are no longer operating in that simple Keynesian world in which some reduction in unemployment could, apparently, always be purchased at the cost of some more inflation. Today it is inflation itself which is the central policy problem. More inflation simply leads to more unemployment.'2

The analysis in this chapter is based mainly on two key sources. The first is Treasury Economic Papers Nos. 3-7. After a five year break, two TEPs were published in 1978: TEP No. 3, Flexibility, Economic Change and Growth: Treasury Submission to the Study Group on Structural Adjustment; and TEP No. 4, Job Markets: Economic and Statistical Aspects of the Australian Market for Labour. These were followed in 1979 by the publication in rapid succession of TEPs Nos. 5-7: Energy Markets - Some Principles of Pricing: Treasury Submission to the Senate Standing Committee on National Resources; NIEO: An Assessment of the Proposals for a New International Economic Order; and, Technology, Growth and Jobs: Treasury Submission to the Committee of Inquiry into Technological Change in Australia. The other key source is Statement No. 2 attached to the annual budget speech. In each statement the Treasury analysed in detail

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economic conditions and policies for the year just passed and provided an outline of the outlook for the coming year.

After a discussion of the Treasury's relationship with the Labor and Liberal-Country Party governments, the chapter examines the department's views on the causes and solutions to unemployment and then examines various aspects of the Treasury's model: the emphasis on mobility and flexibility; the underlying determinism; the belief in the desirability of discipline imposed by market forces; and the undesirability of attempts at purposive intervention.

Political Developments and the Treasury's Fluctuating Fortunes

Relations between the Treasury and the Labor government moved between mutual suspicion and outright hostility. As early as 1973 it was evident that the Treasury's power and influence were on the decline. In July of that year the government decided upon a 25 per cent tariff cut without consulting the department for its advice. The following month Frank Crean, the Labor Treasurer, announced that the government would be budgeting for a domestic deficit of $162 million; Treasury had stressed the need for a surplus. In mid-1974 the department's short, sharp shock strategy was rejected by the Labor Caucus. Persistent, the Treasury again recommended in August 1974 that strong deflationary measures be introduced and again it was ignored. Indeed there were claims that the department had acted subversively, at the very least misleadingly, in the way it presented its budgetary proposals. The Treasury was successful, however, in its recommendations that a tight monetary policy be introduced. In the second half of 1974 the economy was subjected to a particularly severe credit squeeze. If the department could not have its short, sharp shock then it
would have instead, as Maximilian Walsh puts it, a 'long, hard squeeze'. Relations between Treasury and Labor reached their nadir at the end of 1974, the time of the so-called 'loans affair', in which the government attempted to by-pass established Treasury channels and authorised a proposal to raise a loan up to a maximum of US$4,000 million, supposedly for temporary purposes. With the appointment of Bill Hayden as Treasurer in June 1975 a degree of reconciliation was achieved. As noted, Hayden accepted the Treasury's belief that Keynesian trade-off notions were now irrelevant and he agreed that some sort of fiscal responsibility was essential. His budget of August 1975 showed clear signs of Treasury influence, both in principle and practice.

Although the short, sharp shock strategy was rejected by the Labor Caucus, the rise in unemployment which the Treasury believed essential for the restoration of a stronger, more efficient, more disciplined economy was to occur nevertheless - in the form of a widespread, protracted and, by post-war standards, particularly severe recession, beginning about mid-1974. The severity of the recession can be seen in the dramatic increase in unemployment in the second half of 1974. In the March quarter registered unemployment stood at 85,000, declined to 82,000 in the June quarter, then jumped to 123,000 in the September quarter, and by the December quarter had climbed to 214,000. Concomitant with the rise in unemployment, however, was what has been called the wages explosion of 1974, which saw minimum award rates for men increase by 37.2 per cent in the twelve months to October 1974 and those for women by 46.1 per cent. In seasonally adjusted terms average weekly earnings grew at the rapid rate of

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10 per cent in the September quarter of 1974. As will be seen, the causal connection between the trend of wages and the level of unemployment was to be of key importance to the Treasury.

Partly in response to the rise in unemployment and partly out of an anxiety to implement a programme of sweeping social reforms, public sector spending grew remarkably rapidly in 1974-75, the extent of which can be seen in Table 9.1. Public sector expenditure grew rapidly also in 1973-74 but the table shows that receipts grew more rapidly so that in fact a domestic budget surplus was achieved. Although the 1975-76 budget resulted in a larger deficit, both total and domestic, than in the previous year it can be seen that the Labor government had accepted the need for some fiscal restraint - public sector outlays grew at half the rate achieved in 1974-75.

The Liberal-National Country Party coalition government which came to power late in 1975 following the sacking of the Whitlam Government, was much more receptive to the Treasury's views than the Labor Caucus had been: it accepted the need to reduce government expenditure, to avoid budget deficits, and (in theory but not in practice) to de-regulate industry. The Prime Minister, Malcolm Fraser, stressed the importance of fiscal responsibility. If the test of such responsibility is a continuous reduction in the budget deficit then the Fraser Government has lived up to its promises, as Table 9.1 shows. It can be seen that by 1980-81 a domestic surplus had in fact been achieved. The Fraser Government has also managed to stabilise the inflation rate. In 1974-75 the consumer price
Table 9.1: Budget Statistics, 1973-74 to 1980-81

<table>
<thead>
<tr>
<th>Year</th>
<th>Outlays</th>
<th>Receipts</th>
<th>Deficit</th>
<th>Real growth in total public expenditure</th>
<th>Total public sector deficit as proportion of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Percentage Change on preceding period</td>
<td>Total</td>
<td>Domestic</td>
<td>Per cent</td>
<td>Per cent</td>
</tr>
<tr>
<td>1973-74</td>
<td>20.0</td>
<td>25.9</td>
<td>293</td>
<td>-211</td>
<td>6.1</td>
</tr>
<tr>
<td>1974-75</td>
<td>45.9</td>
<td>28.0</td>
<td>2566</td>
<td>1949</td>
<td>16.8</td>
</tr>
<tr>
<td>1975-76</td>
<td>22.5</td>
<td>19.7</td>
<td>3585</td>
<td>2873</td>
<td>2.7</td>
</tr>
<tr>
<td>1976-77</td>
<td>10.3</td>
<td>17.0</td>
<td>2740</td>
<td>1865</td>
<td>2.0</td>
</tr>
<tr>
<td>1977-78</td>
<td>10.8</td>
<td>9.5</td>
<td>3333</td>
<td>2361</td>
<td>3.6</td>
</tr>
<tr>
<td>1978-79</td>
<td>8.5</td>
<td>9.1</td>
<td>3478</td>
<td>2258</td>
<td>-</td>
</tr>
<tr>
<td>1979-80</td>
<td>9.1</td>
<td>16.0</td>
<td>2034</td>
<td>567</td>
<td>2.3</td>
</tr>
<tr>
<td>1980-81</td>
<td>14.6</td>
<td>18.6</td>
<td>1127</td>
<td>-429</td>
<td>3.7</td>
</tr>
</tbody>
</table>

index increased by 16.7 per cent. By 1977-78 the rate of increase had been reduced to 9.5 per cent and has since fluctuated around that figure without showing any persistent downward trend. Unemployment, however, has shown a disappointing and worrisome trend, climbing from 4.2 per cent in 1975 to 6.1 per cent in 1978. 4

Relations between the Fraser Government and the Treasury have not been entirely harmonious; the decision to split the department in November 1976 was eloquent testimony to this. The split was precipitated by heated debates between the Treasury and Fraser in 1976 on the questions of tax indexation and exchange rate devaluation. 5 In the middle of the year Treasury fought strenuously against Fraser's suggestion that tax indexation for individuals and stock valuation for companies be introduced immediately rather than be phased in over three years. Treasury was adamant that the move would result in a severe decline in revenue and thereby lead to a much larger deficit than it considered desirable. The department was not able, however, to convince the Prime Minister and in May the introduction of immediate indexation and stock valuation was announced.

The dispute over devaluation occurred at the end of 1976. Fraser had become convinced that the Australian dollar was overvalued and should therefore be devalued. The Treasury believed, however, that any exchange rate decision should be postponed and was insistent that it was preferable simply to pursue the prevailing policy of expenditure restraint and

4 These are the statistics of the Commonwealth Employment Service. The corresponding statistics provided by the Australian Bureau of Statistics are 4.7 per cent and 6.2 per cent respectively.

5 This discussion of the reasons for the split relies on Paul Kelly, 'Fraser's Brawls with the Treasury', National Times, 4 November 1978.
It seems that the tenacity and doggedness with which Treasury pursued its line in both these instances left the Prime Minister convinced that the department wielded a disproportionate degree of power on economic policy matters within the Public Service. It was partly as a result of this conviction that it was decided to split the department. It was also felt that it had become too difficult for a single minister to be responsible for both economic and financial matters. Thus, it seemed desirable to have two separate departments and two separate ministers. There was the additional advantage that the Department of Finance would be able to concentrate on the task of reducing public sector expenditure - something which the Fraser Government had told the electorate it was keen to achieve.

Another important structural change which occurred in the second half of the 1970s was the decision in 1979 to create a Resource Allocation and Development Division. The Treasury argues that the reorganisation was needed to meet the increased workload placed upon the department and, more particularly, 'to enable appropriate emphasis to be given to longer term issues of resource allocation, economic efficiency and economic development'. As its title suggests, the emphasis of RAD is on microeconomic matters, whereas GFEP is primarily concerned with macroeconomic issues. The establishment of the new division was an apt expression of the evolving nature of Treasury thought and its preoccupation with the supply side.

Unemployment: Causes and Solutions

A notable feature of the recession which commenced in 1974, one which the Treasury was quick to point out, was that the rise in unemployment which occurred was much greater than one would expect to arise simply from the drop in aggregate demand associated with the decline in business activity. To the Treasury, this suggested that there were more fundamental factors than the state of demand which lay behind the rise in unemployment. Of crucial significance were the 'severe distortions to fundamental economic relationships that arose in 1974' which, so it claimed, 'would have adversely affected employment whatever their effect on output'. It argued that the 'fundamental relationship' which had been most severely distorted was that between real labour costs and productivity. The Treasury referred to this distortion as the 'real labour cost imbalance'. It was also commonly known as the 'real wage overhang'. The 'real wage problem', John Stone claimed in 1977, 'was the central and most difficult problem facing the Australian economy'. The Treasury statistics, as shown in Table 9.2, reveal that substantial balance between real labour costs and productivity was maintained from 1966 until 1973. In 1974 and thereafter, however, costs rose more quickly than productivity, thereby producing the overhang.

7 TEP No. 4, p. 30.
Table 9.2: The Real Labour Cost Imbalance

| 1966 | 90 | 88 | 103 | 102 | 91 | 92 | 99 | 100 | 92 | 91 | 101 | 100 | 93 | 93 | 98 | 100 | 93 | 97 | 98 | 98 |
| 1967 | 90 | 89 | 102 | 100 | 91 | 91 | 100 | 100 | 92 | 92 | 100 | 100 | 93 | 94 | 98 | 98 | 94 | 96 | 98 | 98 |
| 1968 | 97 | 98 | 98 | 98 | 98 | 98 | 98 | 98 | 100 | 100 | 100 | 97 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 1969 | 100 | 102 | 98 | 98 | 98 | 98 | 98 | 98 | 98 | 98 | 98 | 98 | 98 | 98 | 98 | 98 | 98 | 98 | 98 | 98 | 98 |
| 1973 | 110 | 110 | 102 | 102 | 102 | 102 | 102 | 102 | 102 | 102 | 102 | 102 | 102 | 102 | 102 | 102 | 102 | 102 | 102 | 102 | 102 |
| 1974 | 113 | 114 | 105 | 105 | 105 | 105 | 105 | 105 | 105 | 105 | 105 | 105 | 105 | 105 | 105 | 105 | 105 | 105 | 105 | 105 | 105 |
| 1975 | 112 | 113 | 104 | 104 | 104 | 104 | 104 | 104 | 104 | 104 | 104 | 104 | 104 | 104 | 104 | 104 | 104 | 104 | 104 | 104 | 104 |
| 1976 | 113 | 114 | 105 | 105 | 105 | 105 | 105 | 105 | 105 | 105 | 105 | 105 | 105 | 105 | 105 | 105 | 105 | 105 | 105 | 105 | 105 |
| 1977 | 118 | 113 | 104 | 104 | 104 | 104 | 104 | 104 | 104 | 104 | 104 | 104 | 104 | 104 | 104 | 104 | 104 | 104 | 104 | 104 | 104 |

Note: As an average 1974-75 prices.
Base period of index: Average 1966-67 to 1972-73 = 100.
Adjusted for average hours worked. Labour costs include payroll tax.
The sector of the economy where employment decisions are largely based on cost and profit considerations is the market sector, and therefore, ideally, real unit labour costs have meaning for employment analysis when calculated for that sector. Data relating to the market sector is only available annually up to 1975-76. In order to provide an indication of the most recent trends in unit labour cost calculations, these are based on data for the non-farm sector.

Source: Reproduced from TEP No. 4, p. 95.

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The real wage overhang argument was based on marginal analysis. The Treasury postulated that: 'Unless the cost of extra labour is less than the value of the resulting output, it will be unprofitable for an employer to take on more employees.' To look at this another way: 'As long as the value of each worker's output rises, then real wages can rise. For the economy as a whole, employment will tend to be sustained as long as the growth in labour costs does not exceed the growth of productivity.' Where labour costs exceed productivity growth, unemployment can be expected to follow. The department insists that this is precisely what happened in 1974 when the real labour cost explosion occurred. The explosion, the Treasury explained,

had the effect of driving a wedge between the value of output produced by the least productive workers employed by firms and the wage that had to be paid to them. Businesses found themselves in the position of having to pay wages to some workers which exceeded the value of their contribution to production and naturally economised by reducing the number of such workers they employed, including through the introduction of labour-saving innovations.

The labour market was considered to be fundamentally the same as any other market and subject to the same forces, the same 'economic realities', as the rest of the economy. Therefore, the Golden Rule of economics continued to apply: 'Wages are, after all, prices, and a basic tenet of economics is the when a price rises (and other conditions remain constant), the quantity demanded falls.'

10 TEP No. 4, p. 31.
11 Ibid.
12 TEP No. 7, p. 23.
13 TEP No. 4, p. 37; in the original this passage was emphasised.
The Treasury argued that the real labour cost imbalance contributed to unemployment in three main ways. First, the rapid rise in wages was the main cause of the significant rise in the inflation rate which occurred during the 1970s and this 'in turn depressed consumer spending, business investment and net exports, and thereby contributed to the overall reduction in the level of output, which in turn led to a reduction in the demand for labour'. Second, the fact that wages rose more rapidly than prices led to 'serious declines' in the profit level of businesses and 'it was only to be expected that business would be looking for opportunities to scale down operations that had become unprofitable, and to reduce their demand for labour, which in most cases constitutes their greatest single cost factor'. The wage explosion also made investment in additional capacity a less desirable proposition and a riskier one. Third, real wages increased relatively more rapidly than other productive inputs, thereby increasing the attractiveness of capital substitution. As the Treasury explained: 'Where there is scope for choice between different technological processes which produce a similar output, higher labour costs will induce business to choose more capital-intensive methods.' Substitution of capital for labour was considered the 'natural reaction' of firms as a means of offsetting rises in real labour costs.

The causal significance of the overhang, in brief, was that higher

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14 Ibid., p. 33.

15 Ibid. The Treasury is convinced that such a process has been going on since the mid-1970s. There is, however, much disagreement about this. For the contrary argument, see Hughes, Exit Full Employment, pp. 166-8.

16 'Statement No. 2 - The Budget and the Economy', attached to Budget Speech 1979-80, (AGPS, Canberra, 1979), pp. 49-50.
real wages had led to higher inflation rates and higher inflation had led to higher unemployment. Whatever doubts they Treasury may have had in 1972 were now erased: the department was convinced that the Phillips curve was indeed dead. The notion of a trade-off between inflation and unemployment, which had been accorded so much significance by the bastard Keynesians, was now patently erroneous. As the department argued in 1975: 'Unlike the foregoing policy paradigm - in which some reduction in unemployment could always be purchased at the cost of some more inflation - it seemed clear that if inflation took off from its present high base it would almost certainly lead before long to even greater unemployment.' From this premise the department derived its policy prescription: 'Fight Inflation First'. As it argued in 1977, 'control of inflation is fundamental to the achievement of other economic policy objectives'. The other key problem, that of unemployment, had to stand in line behind inflation and could not be attended to until prices and wages had been brought into order. That the twin problems of inflation and unemployment could not be dealt with simultaneously and that the unemployment situation might in fact deteriorate in the meantime, was taken to be an unfortunate but unavoidable fact of life, yet another of the Treasury's 'economic realities' that the community had to bear with patient acceptance. Top priority was given to the restoration of business confidence. This required a marked improvement in the profitability of business activities and the restoration of some sort of normalcy in the historical relationship between wage and profit

17 'Statement No. 2 - The Budget and the Economy', attached to Budget Speech 1975-76, (AGPS, Canberra, 1975), p. 19. The same point was made the following year.

The answer to the problem of unemployment lay above all else with a reduction in real wages. As the department argued in 1976:

Unless and until the real wage is brought down relative to productivity in the process of winding inflation rates back, it will not be possible to restore fully the level of economic activity and to provide sufficient new job opportunities to reduce unemployment significantly. In the circumstances that prevail, those who argue for the increase or maintenance of real wages (or those who take decisions intended to increase or maintain them) are in effect, unwittingly or not, contributing to the maintenance of unemployment at present high levels.\textsuperscript{19}

In 1978 the department again claimed that the only way the burden for the market adjustment of real wages to productivity levels could be shifted from the unemployed 'is for some of it to be borne by those, more fortunate, who are employed - that is, for there to be a reduction in real wages'.\textsuperscript{20} At the very least it was essential that there be restraint in money wage claims.\textsuperscript{21}

Given its conviction that real wages had to decline, it is not surprising that the Treasury was highly critical of the decision of the Conciliation and Arbitration Commission in April 1975 to introduce semi-automatic quarterly wage indexation. Given that at the time of its introduction real wages were at an excessive level, wage indexation 'tended to perpetuate those excessive real wage levels longer than a less fettered system would have done'.\textsuperscript{22} There could thus be no doubt that indexation

\textsuperscript{21} Ibid., p. 41.
\textsuperscript{22} 'Statement No. 2 - The Budget and the Economy', 1979-80, p. 49.
'prolonged the duration of the recession and intensified its impact'.

If a reduction in real wages (and hence the abandonment of wage indexation) was the key to an improvement in the employment situation, what was the role of government? Prior to 1975 the Treasury seemed to embrace an essentially Keynesian line in its public statements on government policies. In 1973 it continued to endorse what was then a well-established Treasury tenet, that given the uncertainty of economic events, it was essential that government policy be flexible. As it argued in a statement attached to the budget speech of 1973-74, 'Any assessment of economic prospects in 1973-74 must ... be subject to a degree of uncertainty and, for this reason, policies must be readily adaptable to changing economic circumstances.'

In 1974, in one of its Taxation Papers, the Treasury rejected the concept of automatic adjustment of taxation for inflation and was strongly supportive of discretionary taxation policies:

from the demand management viewpoint, an automatic adjustment procedure would severely restrict the flexibility of the government in the use of its fiscal powers. By contrast with a system where periodic reviews of the income tax rate scale are undertaken, the merits of an automatic adjustment procedure are questionable. The rate of growth in revenue in inflationary periods would be reduced if automatic adjustments are made, whereas prudent demand management might suggest the need for the opposite outcome. The progressive rate scale does provide a braking mechanism on the growth of after-tax incomes and hence of spending power which can be quite valuable in times of


The department claimed that 'it would be fair to say that the consensus of opinion supports a need for discretionary action' and, interestingly, continued: 'Indeed the alternative view is a counsel of despair - it implies that governments are more likely to be wrong than right in judging the need for stabilisation policy action.'

From 1975 onwards, however, there was a notable change in the Treasury's views on the efficacy of government policy which attempted to reduce unemployment permanently by any form of purposive intervention. The department seemed to have abandoned the Keynesian notion of economic control. It became convinced that budgetary deficits were self-defeating and would in fact worsen the employment situation. Such arguments appeared repeatedly in Treasury documents. In 1976, for example, the department claimed that it was because of their effects on consumer and business confidence and thereby on final demand that 'the earlier fiscal and monetary stimuli [of the Whitlam government in the form of large budget deficits and large absolute increases in public expenditure] proved ineffective and the upturn in activity in the first half of 1975 that they had sought to foster proved to be unsustainable'. It continued, interestingly using a Marxian metaphor: 'By adding to inflation and inflationary expectations through large budget deficits, and the associated excessive additions to liquidity, the massive stimuli of 1974-75 carried

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within themselves the seeds of their own undoing.' Similarly, in 1977 it argued that: 'Recovery could not be sustained by burgeoning public expenditures because the offsetting intensification of inflation and inflationary expectations was generating offsetting depressive effects on private expenditures and eroding the international competitiveness of domestic producers.' In 1978 Keynesian ideas were rejected outright: 'The degree of unemployment and under-utilisation of capacity that now exists is not primarily the product of deficient demand in the private sector of a kind that can be lastingly boosted to any desired degree by conventional fiscal/monetary stimulus.' To provide a final example, in 1979 John Stone delivered a paper on the budget deficit and the economy, the explicit aim of which was to show 'that, in current economic circumstances in Australia, a policy of expanding the budget deficit, whether by increased government spending or by reduced taxation, would not achieve the ends to which it would presumably be directed. That is it would not lead to expanded output and employment, at least in any sustained sense, but rather would darken prospects in those areas.'

The Treasury's resistance to any form of stimulatory fiscal action

28 'Statement No. 2 - The Budget and the Economy', 1977-78, p. 16.
29 'Statement No. 2 - The Budget and the Economy', 1978-79, p. 31. The Treasury also argued that: 'The experience of recent years clearly implies that, under current conditions, an attempt to force the pace of aggregate demand growth would tend to result more in a higher price level and adverse balance of payments responses than in enhanced economic activity.' Ibid., p. 32.
reflected the influence of the rational expectations school. Unlike the adaptive or inflationary expectations of Friedman and Phelps, which argues that economic agents can temporarily be 'fooled' by governments, that economic agents can make systematic errors with regard to the course of price movements, the rational expectations of Barro, Fischer, Lucas et al. insists that economic agents are peculiarly sensitive to price movements and adjust their behaviour more or less instantly to such movements, thereby maintaining a market clearing situation. It is impossible for the government to fool such agents - it is one of their chief characteristics that they are quick to realise the significance of changes in the government's policy stance; in particular they are well aware that any expansionary policy will ultimately serve only to increase the money supply and thereby lead to an increase in inflation.

One can see clearly the influence of the rational expectationists in the Treasury's analysis of the effect of budget deficits. In 1978, for example, it argued that "the community's "inflation psychology" must be judged highly sensitive to shocks such as would be signalled, for example, by any basic shift in the thrust of policy", and continued: 'It may therefore be regarded as a necessary condition for the maintenance of the recovery process that prices continue to decelerate, and be expected to continue doing so.'31 Similarly, Stone argued in 1979 that: 'Expectations now adjust rapidly to changing economic circumstances and find their rapid reflection in actual economic behaviour.'32 Pursuing this line, he

31 'Statement No. 2 - The Budget and the Economy', 1978-79, p. 32; emphasis in the original.
32 Stone, 'The Budget Deficit', p. 22.
declared that he was convinced that the expansionary policies of the
Whitlam Government failed essentially because of the adverse effects on
expectations. Memories of this period lingered on and as such any increase
in the budget deficit arising from an increasing in expenditure would be
interpreted 'as a step back towards "big government" spending, associated
as that was with the turmoil of the the mid-70s' and would thereby alarm
economic agents, making them more cautious. Stone continued by putting
forward a straightforward rational expectations argument:

It is fashionable in some quarters - though perhaps less so
than it was - to dismiss or even deride such concerns as
'irrational' and to go on from that to argue that what is
really needed is a campaign of 'public education' to accompany
the increased deficit in order to overcome that
'irrationality'. Personally, I do not believe that a
'brainwashing' approach of that kind would be in any way
effective, for the very good reason that ... the concerns in
question are in fact very rational indeed. In short, in such
circumstances consumers and/or businesses actually do have good
grounds for expecting the economic outlook to deteriorate. If,
as would be likely, this were reflected in their own spending
decisions, the 'expectations' effect would bring forward that
'real' deterioration.

Stone went on to make a similar point, explicitly acknowledging that he was
reiterating the rational expectations viewpoint:

I can only say that my very clear judgment is that in present
circumstances the result [of an expansion in the budget
deficit] is likely to be adverse - and considerably so. This
judgement is reinforced by my conviction that the attitude
which it attributes to the private sector (i.e. that an
increased budget deficit and the tendency that involves towards
higher inflation are fundamentally disruptive to economic
stability) is basically correct. This, in the formation of
'rational expectations', can only serve to bring the adverse
consequences closer in time so that there may not even be the
appeal of short-run positive activity and employment
consequences flowing from fiscal stimulus.

33 Ibid., p. 27.
34 Ibid.
The clear implication of Stone's argument, which is at the heart of the rational expectations stance, was that so-called stabilisation policy was in fact destabilising. The Keynesian stance, the notion of purposive intervention, was anathema.

The upshot of the Treasury's rational expectations approach was that the government could only establish (and should be content to do so) what it refers to as the 'pre-conditions' for recovery or, more generally, for the conduct of economic affairs. It could only establish a favourable 'environment' which would encourage the private sector, in which resided the true source of capitalist drive and vitality, to restore the economy to full activity.

Such an environment was one which increased the scope for market forces to operate, helped to remove distortions surrounding price signals (oil parity pricing was thus welcomed), facilitated change and encouraged mobility and flexibility, and provided a flow of reliable and up-to-date information for rational expectations. In an attempt to do this, a broad, not specific, policy approach should be adopted.

The Treasury maintained that the government needed to set a good example. As it argued in 1976, if the budget deficit of 1976-77 had been larger than in the previous year then '[i]nflationary expectations and inflation would have been exacerbated, [partly] because such an outcome would have been seen as a failure by the government to control its own activities'. If the government attempted to control inflation by

tightening monetary policy but attempted also to deal simultaneously with unemployment by increasing the budget deficit, then 'there will be effects on perceptions in the private sector and in centralised wage setting of the following kind: "the government says it's pursuing an anti-inflation policy yet it can't even get its own house in order; look, its resorting to still larger Budget deficits; we do not believe it"'. Given the importance of expectations it was essential that the government's policy aims be credible. An essential pre-condition which the government should aim for was the achievement of budget balance and, as an important ingredient of this, a decrease in the absolute and relative size of public expenditure. The government had to exercise the same restraint it believed the rest of the community should exercise. Moreover, it was not enough to preach; practice was crucial. The government had to show that it was genuine in its attempts at restraint. It had to convince economic agents of its intentions and its trustworthiness.

Reflecting the influence of Friedman, the Treasury argued that another important role the government can play is the establishment of monetary targets or ranges. It believed that:

The announcement in each of the last two Budget Speeches (and initially in March 1976) of a successively lower projected range for M3 growth in the financial year has contributed substantially to a return to stability and greater certainty in financial markets. The projections have effectively fulfilled their intention of indicating the Government's expectations for the appropriate monetary environment consistent with progress towards its economic objectives. Given the outcomes, it must be judged that these policies have made an important contribution to the success of anti-inflation policy.  


The Treasury stressed that it was in favour of 'conditional projections' rather than 'precise and rigid' M3 targets. Monetary projections were 'a manifest to seek stability' in the midst of 'a still highly uncertain and inflation-ridden world'. To be more specific, the aim of the monetary projection ranges was that they should:

(a) demonstrate that the aims of monetary policy fit within a coherent overall policy;

(b) indicate that greater medium-term 'steadniness' in monetary management is to be pursued but without abandoning an appropriate measure of discretionary responsiveness; and

(c) by providing a 'peg' of stability, attempt to exert a direct influence upon public expectations, which in present-day conditions are central to the inflationary process. 39

As can be seen in point (b) above, the Treasury was not advocating a laisser-faire stance toward economic policy. It has not abandoned completely the idea of discretionary policies. 40 This perhaps was not surprising. As has sometimes been suggested, if there was no scope for discretionary policies there would be very little need for the Treasury, given that its role is to manage the economy. Nevertheless, it is clear that by the mid-1970s, and increasingly thereafter, the Treasury was sympathetic with the neoclassical line that intervention should aim to provide a stable, orderly environment for economic activity by setting rules and establishing a clearly defined framework. Such a framework did

39 'Statement No. 2 - The Budget and the Economy', 1979-80, pp. 46-7. Monetary targets are discussed are also discussed in Treasury Paper No. 2: Monetary Policy, pp. 10-12, 33-38.

40 Recently, the Treasury has argued in favour of some direct regulation of the exchange rate rather than allow it to be determined solely according to market forces. See Submission to the Committee of Inquiry into the Australian Financial System, Treasury Paper No. 4: Foreign Exchange Arrangements, December 1979, passim.
not preclude changes in policy but it did insist that changes should occur only gradually, should be clearly articulated, and should be understood by all. The discretionary element should be exercised with extreme caution.

**Flexibility, Mobility and Market Discipline**

Flexibility and mobility were concepts which figured prominently in the Treasury's model and which provide further evidence of a predominantly neoclassical outlook. The Treasury's rational economic agent, attempting to maximise his position, responded to a price increase of a particular product by economising on the use of that product and altering his spending away from that product to cheaper alternatives. Not only was it believed that economic agents attempted to achieve particular predetermined and subjectively desired ends, but it was believed that they were willing and able to substitute one product or resource for another, to try alternatives, and to shift their spending patterns. The determinant of such behaviour was the movement of relative prices. Mobility and flexibility were considered inherent features of the economy. The Treasury declared that: 'Individual structural problems should not be allowed to obscure the broad picture of a flexible economy in which many people are willing to change their job and the location of their work, and acquire new skills.' 41 Again, 'A mobile labour force is ... both a necessary condition for, and an inevitable product of economic development and growth'. 42 Reference was made also to 'the inherent flexibility and mobility of the

41 TEP No. 3, p. 22.
42 TEP No. 4, p. 24.
labour force'. But just why the mobility and flexibility of the labour force was both inevitable and inherent was not explained.

That which tended to hinder or obstruct mobility and flexibility was viewed with disdain. So too was that which distorted price signals. Thus advocates of schemes to set Australia's energy prices at below parity levels incurred the Treasury's wrath. To set prices at such levels 'simply confer[red] an unnecessary subsidy on energy users and their customers and induce[d] them to make economically inefficient decisions about consumption of and investment in energy-using products and processes'. Inflation, similarly, was seen as a fundamental evil because it distorted the signals upon which economic decision-makers acted: 'Inflation distorts the relationships between consumption and savings, and output, growth and investment, in ways which create unemployment and reduce the economy's capacity for sustained growth.' Here the Treasury was reiterating a fundamental tenet of the neoclassical model referred to in Chapter Three: that the stability and efficiency of the economic system is a function of the extent to which prices are able to move unhindered in response to changing market conditions and of the extent to which economic agents adjust their consumption and production patterns in response to price signals.

The Treasury insisted that the longer prices remained distorted the more 'painful' would the adjustment process be. For instance, in the case

43 TEP No. 7, p. 22.
44 TEP No. 5, p. 6.
45 Ibid., p. 11.
of energy resources it argued that: 'The longer distorted prices are maintained, the more businessmen and consumers will become committed to economically inappropriate decisions about energy use and energy using equipment, resulting in the longer term in even greater adjustment costs.' 46

This argument, that to try to elude economic realities 'will serve only to make the inevitable long-term adjustments more painful', has much in common with the views of monetarists on the inevitable discomfort which has to be endured because of futile and misguided attempts in the past by governments to maintain unemployment below its natural rate. The nature of the monetarists' panacea has been described by J.A. Trevithick:

Inflation can only be successfully tackled by reversing the direction of the policies which produced the inflation in the first place. A régime of strict monetary restraint will therefore be accompanied by unemployment rates in excess of the natural rate, for it is only thus that the necessary erosion of inflationary expectations can occur. If the government is determined to conquer inflation, it must be prepared to stomach the unpopular consequences implicit in a policy of monetary contraction. An inflationary binge will inevitably be followed by a deflationary hangover. 47

A somewhat similar line of thought prevailed in Australia in the 1930s: past indiscretions and excesses in the form of over-borrowing and over-spending by governments were seen as the main cause of the depression. The prescribed antidote was to reverse past practice and adopt compensatory restrictive attitudes and policies. A similar compensatory stance has dominated budgetary policy since 1975, as is suggested by the various titles employed to describe it - such as the need for

46 Ibid.
responsibility, for reigning in the deficit and keeping it firmly tied to
the rail, for tightening the purse strings, for paying off the debt of the
Whitlam years, and for getting the country back into the black.48

A compensatory mentality could be detected also in the following
comments by John Stone in 1977:

until the profit share gets back at least to where it used to
be we will not see recovery to anything like the kind of 'full
employment' world to which we now look back nostalgically. And
having used a comparison of 'where we used to be' I would also
go further to say that my own personal view is that the profit
share will need to rise, at least for some time, above 'where
it used to be' if we are to get a sustained rise in private
fixed investment.49

The clear suggestion was that recovery would be dependent not just on the
profit share increasing but, more importantly, on it rising above the level
it had maintained during, presumably, the 1960s. Similarly, H.N. Johnston,
an Assistant Secretary in GFEP, argued in 1979:

the effects of the [real wage] overhang could well linger on
[after it has been largely erased] as the stigma attaching to
labour - that it is overpriced - could well take some time to
wear off. There may also be a case for overcorrection of the
overhang to redress the loss of business profits and boost
firm's [sic] confidence in the market and in the prospect for
satisfactory returns from future investments.50

Again the suggestion, emphasised by Johnston himself, was that it was not
enough to return to some supposed normal relationship between wages and
productivity. Instead, the balance had to tip in favour of productivity
and hence profits. No indication was given, however, as to how long such

48 These various descriptions appeared in Michelle Grattan, 'Fraser
Relies on his Record', The Age, 19 August 1980.


50 H.N. Johnston, 'Real Wages and Unemployment', Australian Economic
Review, 1st Quarter 1979, p. 88; emphasis in the original.
overcorrection would be necessary or as to how one would judge that the overcorrection was sufficient.

Linked with this compensatory mentality was an acceptance of the need for discipline. Underpinning the perceived need for discipline, as argued in the previous chapter, was a sceptical view of inherent human proclivities. It was assumed that an environment in which discipline was lacking (a world in which the government pledged both the maintenance of full employment and protection from external competition was an obvious and relevant example), would inevitably give vent to deleterious behaviour. Such behaviour would then require compensatory action. On this view, it would be to the benefit of the economy if discipline was maintained. For this would obviate the need for compensatory purges. The Treasury believed that one of the great benefits of the market system was that it instilled the discipline which economic agents were unwilling or unable voluntarily to impose on themselves. Discipline was in-built into the market:

Since predictions of industry profitability inevitably carry a component of judgement and a possibility of error, it is critical that society retain the flexibility to discard investments premised on forecasts which turn out to be faulty. This flexibility is built into the market system of profits and losses which disciplines investors and holds them accountable for their forecasts. Bad private investments are not perpetuated; good ones are expanded.51

In a similar vein, the Treasury argued that the major strength of phased protection reductions 'is the continuous, automatic pressure they put on the affected industries to slough off their least efficient firms, processes and products'.52 The discipline of the market was seen to be purifying. It was akin to a cleansing process in which impurities were

51 TEP No. 3, p. 43.
52 Ibid., p. 38; emphasis in the original.
filtered. That the purification process might be punitive was implicit. Such arguments had a Social Darwinian flavour in that the department was asserting that in a market economy the weak and the inefficient cannot and will not be tolerated. The Treasury view was that although mistakes will be made, although predictions are subject to the possibility of error, an in-built, and hence natural, feature of the market system is that mistakes will not be repeated over and over, corrections will be made.

The Treasury's Underlying Determinism

Underpinning such arguments was a deep conviction concerning the determinism, the inexorability, of economic processes. The Treasury's determinism was brought out clearly in its insistence that the real labour cost imbalance or overhang would eventually be corrected by market forces. In 1977 it argued that: 'Clearly, if the wage settlement processes do not serve to further reduce the share of labour in the national income, market forces will operate to reduce employment or at least the rate of growth of employment, and the same end will be attained - but more slowly and much more painfully.' In 1978 it claimed that: 'The market's adjustment to correct for the persisting real wage overhang is, one way or another, inevitable.' Similarly, in 1979 it insisted that: 'an excessive level of real wages has necessitated adjustments, one way or another, in the economy and ... while excessive real wages persist, high unemployment will be an inevitable concomitant of that adjustment', and

53 'Statement No. 2 - The Budget and the Economy', 1977-78, p. 32.
continued: 'one way or another [basic economic realities] will effect their influence; the question of course is how long that will take, and what otherwise unnecessary costs will be incurred along the way'.

The department's underlying determinism could also be seen clearly in its belief that the complex linkages, interrelationships and interdependencies between economic agents were such that the economic system was able to cope with any endogenous or exogenous disturbances. Numerous statements reflecting this assumption were scattered throughout the TEPs. To provide four examples: 'market economies embody complex linkages across markets, such that the very process of decline in some industries signals the opportunities for expansion in others';

'if protection were reduced for the presently highly protected industries ... market interdependencies would maintain employment opportunities, balance of payments equilibrium and other economic objectives';

'fears of balance of payments crises following on reductions in high protection ... understate the degree of interdependence within the economy and the capacity of markets to eliminate imbalances';

'where job displacement in a particular industry can be shown to accompany technological change the associated cost savings transmitted to other parts of the economy give rise to the potential for new and increased demands and, if the potential is realised, new employment opportunities'.

55 'Statement No. 2 - The Budget and the Economy', 1979-80, p. 50.
56 TEP No. 3, p. 7.
57 Ibid.
58 Ibid., p. 8.
59 TEP No. 7, p. 17.
By asserting that the economy had a tendency to eliminate imbalances, the Treasury was of course arguing that the economy was self-regulating, that it had a tendency toward equilibrium. In fact the department adopted an explicitly Walrasian point of view and insisted that 'there exists a broad tendency towards general equilibrium across all markets'. In TEP No. 7 reference was made again to 'the tendency of the adjustment mechanisms inherent in the economy to work toward equilibrium'.

That the adjustment mechanism was only a tendency was emphasised. It was argued that it was incorrect to assume 'that the general equating of supply and demand in all markets is ever fully achieved'. But the Treasury remained convinced, nevertheless, that 'economies tend to move towards the elimination of imbalances in supply or demand'. It maintained that 'even

60 TEP No. 3, p. 7.
61 TEP No. 7, p. 19; emphasis in the original.
62 Both quotes are from TEP No. 3, p. 3n. One can see this assumption also in the theoretical analysis underpinning the Treasury's NIF model. As Higgins and Caton, both Treasury officers, have argued: 'In order to proceed from a general view of the causal channels in macroeconomic systems to the representation of an actual macroeconomy, it is necessary to provide a specification of the disequilibrium phenomena involved in the causal relationships. Disequilibrium is here meant in the sense that if a disturbance is introduced into an equilibrium situation then the system does not instantaneously move to a new equilibrium but adjusts over a period of time. Some of these adjustment processes are short-lived while others are drawn out. Because shocks are occurring continually, and because many adjustment processes are lengthy, an empirical view of the functioning of a macroeconomic system tends, appropriately, to be dominated by the nature of the adjustment process.' Caton and Higgins continued in a footnote: 'Although we are referring to the system as being in disequilibrium in particular time periods in the transition, an acceptable terminology describes these as temporary (constrained) equilibria on the path towards a less constrained, more permanent equilibrium.' C.N. Caton and C.I. Higgins, 'Simulation Analysis with a Macro-Econometric Model'. Paper presented at the 5th Conference of Economists, Brisbane, August 1975, mimeo., p. 1.
within a highly ossified framework, market forces are still operative in seeking to offset the consequences of that ossification'.

The Treasury and Purposive Intervention

Such assumptions are of obvious importance in understanding the Treasury's views on the notion of purposive intervention. To the Treasury, that which occurred naturally should generally not be tampered with. In line with the views first put forward in 1964 in Economic Growth, it asserted that 'there can be no rational justification for aiming at any pre-determined economic structure, or seeking to defend the existing economic structure'.

Changes in the economic structure were considered 'only the means through which the economy keeps pace with the changing demands the community makes of it'. As such, 'Particular economic structures or directions for change cannot sensibly be advanced as ends in themselves.' As will be considered in more detail shortly, from a political point of view such arguments amounted to a rebuttal of the notion of purposive intervention in that they implied that governments should not attempt to mould the nature of economic change or to question the desirability of the direction of change. To do so would be to question that which had been ordained by the decisions of each individual member of the community. In the Treasury's eyes such action was irrational. The collective results of individual

63 Ibid., p. 54.
64 TEP No. 3, p. 2.
65 Ibid.
66 Ibid., p. 10.
decision-making were considered sacrosanct.

Linked with such views, the Treasury maintained that the direction and nature of economic change could only be recognised and meaningfully discussed in an *ex post* sense. To look at this from another perspective, the department was arguing that to try to ascertain what will happen in the future is a particularly difficult, indeed impossible, task. Its view was that it was foolish to believe that forecasting, once past the short-term, was amenable to providing anything more than a rough guide to future trends:

Economics is an aspect of general social behaviour and as such, the economic future is no more precisely predictable by disinterested technocrats or central governments than future trends in general social matters. Since the ultimate direction of change derives from individual behaviour and values, the economic and social future must always retain sufficient elements of uniqueness and spontaneity to defy forecasting based solely on past experience.67

Because of the complexity and interdependency of the economy and the variety of stimuli which operated in it, there was 'no simple way in which the net effects of change can be aggregated to anticipate the effects on the economy as a whole'.68

For all of these reasons the Treasury adopted a cautious attitude toward econometric models, as exemplified in Stone's comment in 1977 that:

Everybody who has been even peripherally associated with the behaviour of the econometric models over the past few years understands very clearly that they have not been behaving very well during that time, principally for the reason that tremendous shocks have affected the economy along with consequential shifts in expectations. The models simply have

67 Ibid., p. 9.
68 TEP No. 7, p. 17.
The department's view was that the predictive usefulness of econometric models was inversely related to the time-span being analysed. This was so because all econometric models were based on an analysis of past relationships and because all future events were characterised by elements of spontaneity and uniqueness which provided inescapable sources of error for predictions based on past relationships.

However, there was something paradoxical about the Treasury's stance. It emphasised that 'meaningful anticipation of the effect of any particular change [is] inherently unknowable [as] it depend[s] on how a host of investors, entrepreneurs and individual workers react to the multitude of changes involved'. It emphasised also that the world was complex, interdependent and subject to a multitude of forces. And it argued that the fact that 'future economic prospects cannot be made as concrete as present realities' was an 'inescapable constraint'. But one can ask: if accurate prediction of the effects of economic change is impossible because it is inherently unknowable, then how can one be sure that even rough directional tendencies which may have operated in the past will continue to operate in the future? Why are these tendencies not inherently unknowable? A similar problem arises from the Treasury's

70 But while models were of little value in predicting medium and longer term developments with tolerable accuracy, they were considered useful as 'analytical tools for considering different possible scenarios'. TEP No. 7, p. 27.
71 TEP No. 7, p. 19.
72 TEP No. 3, p. 10.
argument that 'any society must appreciate that its decisions about the
future must be taken from a rather shaky base of less than perfect
knowledge'. To acknowledge that people's decisions are based on
imperfect information must imply that the economy is an indeterminate
system. For if one has imperfect information one cannot be certain that
one's actions are maximising (assuming that people are maximisers); one
cannot know how far one is from achieving an optimum result; and one cannot
be sure whether a price is correctly or incorrectly reflecting a
commodity's scarcity. One therefore has difficulties in deciding what
action to pursue. Because of lack of information, an attempt at rational
action (in the neoclassical sense) may in fact be quite irrational. Thus
to argue that the economy has an inherent tendency toward equilibrium while
conceding imperfect information seems particularly tenuous. This is
where the argument raised by Keynes, and in particular by Joan Robinson, is

72 Ibid., p. 9.

73 One possible escape route, which the Treasury would probably have
used, is to run into the protective shadows of rational expectations
theory and claim, as do Dornbusch and Fischer, that although economic
agents have imperfect knowledge, 'individuals use information
efficiently and do not make systematic mistakes in their expectations'
or, as Ackley puts it, claim that 'economic agents are capable of
correctly anticipating the effects of their own and others' actions'. R. Dornbusch and S. Fischer, Macroeconomics, Second
403. However, one is left puzzled, faced with such definitions, as to
the difference, at least conceptually, between rational expectations
and perfect knowledge. There is in fact little difference between the
two. Indeed Dornbusch and Fischer note that: 'Perfect foresight is a
special case of rational expectations that holds when their is no
uncertainty.' Dornbusch and Fischer, Macroeconomics, p. 583n. Poole
quite correctly points out that: 'Rational-expectations theory must
be regarded, in principle, as only slightly amending perfect-certainty
models. One need only substitute the assumption of perfect knowledge
of probability distributions for the assumption of perfect knowledge
of outcomes.' William Poole, 'Rational Expectations in the Macro
important: given that life exists in historical time, the future must always be uncertain. Indeed at the base of the Keynesian position is the belief that government intervention is necessary to guard against the potential disorder flowing from this fact of an uncertain future.

The Treasury utilised its criticisms of econometric modelling to undermine the arguments of those who believed in the possibility of governmental fine-tuning of the economy and of those in favour of the broader objective of 'directive' intervention. The department argued that a serious weakness in demands for more direct government intervention was that such intervention relied upon forecasts derived from econometric models. Inevitably, therefore, so it was argued, directive intervention was subject to all of the insuperable problems intrinsic to the forecasting process. As noted in Chapter Six, such arguments had been used by the department in 1962 in a rebuttal of economic planning. The Treasury was now extending the argument to rebut the notion of fine-tuning.

The need to rely upon the forecasting process was but one of a range of weaknesses which the Treasury saw in the arguments of those who favoured directive intervention. An additional weakness was that such advocates made 'insufficient allowance for the operation of prices and markets and the continuum of economic adjustments that tend to bring about the equality of supply and demand'.74 To assume that the economy's inherent adjustment mechanisms could somehow be aborted was dismissed as 'unrealistic'. Keynes's theoretical contribution, in particular the notion of underemployment equilibrium, was considered untenable by implication.

74 TEP No. 7, p. 27.
A key weakness with purposive intervention was that it led to inefficiencies. The main problem was that 'it is only possible to make concrete the directions of future change at a great cost to overall economic welfare by way of ongoing public support for the uneconomic progeny of incorrect government predictions'. In other words, government intervention was undesirable because ultimately it involved substituting dependence for discipline. The Treasury's reasoning was as follows. Step one: government forecasting is not subject to the same stringent review experienced in the private sector. Step two: moreover, '[o]nce a politically dependent investment and its associated jobs have been established, the "clients" have a very strong claim over their "benefactor" should things turn sour'. Step three: 'as the government cannot allow that industry to fail, its managers and workers are consequently spared the discipline of selling their products on its merits'; the industry has 'a diminished incentive to adjust to changes in the commercial world; a diminished incentive to make the investment profitable'. Step four: the result 'is a highly inefficient economy and a reduced level of national economic welfare'.

**Discipline versus Dependency**

The Treasury's dislike of budget deficits was not just because of its

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75 TEP No. 3, p. 7.
76 Ibid., p. 9.
77 Ibid., pp. 9, 43.
78 Ibid., p. 43.
supposed harmful effects on inflation and inflationary expectations but, as with protection policies, because such deficits necessarily entailed a dependency relationship. As it argued in 1979: 'the deficit arises fundamentally from the high level of public expenditure. That in itself, and particularly when public expenditure increases rapidly, can impair the vitality of the private sector even if it is fully met by taxation. Dependencies are created; entrepreneurship and individual effort are weakened.'

The Treasury's obvious distaste for the notion of dependency was the converse of its insistence on the need for discipline. The department's ideal was to have 'tough' decision-makers who would stand on their own feet, suffer fully the results of miscalculations and misjudgements, be forced to plan more carefully, calculate more carefully and with increasing sophistication, and who would necessarily be aggressive and competitive because economic success depended upon such characteristics. Such an ideal could not tolerate soft options, protective devices, safety valves. As the Treasury told those underdeveloped countries clamouring for a new international economic order: 'economic development is primarily dependent on a country's own efforts'. There was no point in offering handouts or concessions to such countries. Strength was derived from initiative, from successful struggle.

As part of this attitude, the Treasury stressed that economic agents should recognise that the government, even if wanted to, could not

79 'Statement No. 2 - The Budget and the Economy', 1979-80, p. 41.
80 TEP No. 6, p. 3.
guarantee full employment. The experience of the 1950s and 1960s had been misleading, had distorted people's expectations. As it argued in 1979:

So far as the effectiveness of instruments is concerned, there is probably still, as a legacy from the sustained period of good economic performance in the 1950s and 1960s, an unwarranted belief in the controllability of the economy and in the proposition of use of policy instruments — that is to say, in the possibilities for 'fine-tuning' offered by macroeconomic policy.... That is, to be sure, a continuing area of controversy, but the experience of the 1970s throughout the industrialised world suggests that policy advisers are hardly being myopic if they argue that the degree of policy effectiveness is severely limited, that 'controllability' is circumscribed.81

Keynesian optimism had been abandoned. Pessimism, resignation to an inevitably protracted recovery, was now the spirit of the age.

Conclusion

A point made in the previous chapter was that the Treasury was convinced that Australia's economic difficulties were the result of collective interference. But whereas the chief object of complaint at the turn of the decade was the trade union movement; during the 1970s it was the government which increasingly came to be seen as the villain of the piece. This move reflected the rise of neoconservatism noted earlier — one of the

81 Treasury Paper No. 2 - Monetary Policy, pp. 15-16. Similarly, Stone argued in 1979 that the experience of full employment prior to the 1970s 'strongly conditioned the framework of expectations within which our economies failed to cope with the particular shocks when the latter occurred. The genesis of that failure is to be found in the effects on aspirations and expectations of three decades of so-called "full-employment policies". That conditioning ... now has the apparently paradoxical result that "full employment" (as we were wont to define that term) has now become, at any rate for a time, inherently beyond the grasp of any government (of whatever political persuasion) in this and many other countries.' Stone, 'The Budget Deficit', pp. 29-30.
distinguishing characteristics of neoconservatism is that the notion of big
government is considered anathema. It reflected also the budgetary
indiscipline, indeed recklessness in the eyes of the Treasury, of the
Whitlam Government. The fact that the Treasury was virtually ignored by
Labor throughout 1974 intensified the department's feeling of ill-will
toward not only Labor but the notion of government in general. The
Treasury's view was summarised by Frederick Wheeler in his retirement
speech in 1979 when he declared: 'All politicians are bastards.' They
were, in addition, ever-willing to spend and to interfere and to go always
for the soft-option.

Another institution which came to be treated with considerable
scorn by the Treasury was the Commonwealth Conciliation and Arbitration
Commission, a body staffed in the main by non-economists making decisions
of profound economic importance and, to the Treasury, pernicious
consequence. John Stone was all too willing to denounce the Commission.
Speaking in 1979, he complained that its decisions 'are not notable as
models of economic, or indeed even logical clarity, and therefore it is
usually difficult to identify from within them the factors influencing that
body'. The Commission's decision to reintroduce wage indexation was seen
as a perfect example of an unwillingness or inability to accept and face up
to economic realities.

The individual, by contrast, was considered fundamentally
rational. The nature of collective interference, however, was such that it
sometimes had perverse effects on the pursuit of individual self-

82 Stone, 'Budget Deficit', p. 25.
interest. For example, the Treasury maintained that an attempt by an individual firm to become politically dependent was not necessarily a manifestation of irrational tendencies. On the contrary, in a situation (Australia's protection system being a good example) in which profitability was dependent on influencing governments, it was 'entirely rational' from the individual company's point of view 'to devote its best efforts to securing the most extensive government support possible'. The problem with such actions, however, was that while they represented rational attempts by individual firms to maximise profits, at an aggregative level 'scarce resources are diverted from production into socially unproductive competitive lobbying'. The underlying belief was that the source of economic irrationality and economic instability lay outside the individual.

In this there is an interesting contrast with Keynesian views. The Keynesian model shares with classical and neoclassical analysis an overriding concern that order and stability be preserved and that rational action prevail. The Keynesian model also shares with the neoclassical the belief that instability originates from outside the individual - a necessary assumption to preserve the foundations of the culture. But whereas the neoclassicist insists that it is collective interference (in the form of the government) which is the source of instability, the Keynesian argues that it is the system which is at fault. In the Keynesian

conception governmental intervention is seen in a positive light; it is essential for the preservation of social democracy.
Chapter Ten: Explaining the Transition

The analysis in Parts Two and Three leads to a crucial question: why did the transition from Keynesianism to neoclassicism occur? The aim of the present chapter is to attempt to answer this question. It should be made clear at the outset that the transition was of course a complex phenomenon and an attempted explanation of it must necessarily be incomplete. Understanding often seems to be linked directly with the available temporal perspective and the main problem here is that the change has occurred so recently.

It has been suggested in earlier chapters that within the Treasury the age restructuring which occurred throughout the post-war period contributed to the transition in its thought. The Treasury was staffed by an ever-increasing stream of officers whose formative years belonged to the post-war period with its continuous high growth and high employment and who, by the end of the 1960s, were taking over from officers such as Wilson and Randall who had entered the Treasury during World War II or shortly thereafter and whose ideas had been moulded by the depression. John Stone himself has emphasised the importance of changing age structure on economic thought and ideas:

In the early post-war years, and indeed, albeit with diminishing force, until very recently memories of the 1930's lingered.... Today, however, we are nearly 25 years into the post-war period, and nearly 30 years past those fearful pre-war years. Those whose minds were shaped by the experiences of those years, whether their personal experiences or those of their parents, are a steadily declining proportion of our communities. Quite literally, they are a dying race. Within the totality of decision-making, small and great, which goes to shape the outcome within our private enterprise societies, the 'weights' have therefore been shifting steadily towards the new men (and increasingly, women) whose memories and expectations

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But why do different generations have such different memories and expectations? This leads directly into the question of why was Keynesianism abandoned.

An obvious and important reason for the growing dissatisfaction with Keynesianism was the fact that from the early 1970s onwards unemployment was experienced concurrently with inflation. With the persistence of stagflation, Keynesianism became increasingly untenable. It was argued that from a Keynesian perspective it was impossible to explain the coexistence of inflation and unemployment. Nor was it possible to remedy it using Keynesian techniques. According to simplistic Keynesian ideas, unemployment arose when aggregate supply exceeded aggregate demand, and inflation arose when demand exceeded supply. To an ever-growing proportion of the community the fact that both inflation and unemployment could occur at the same time seemed to make nonsense of Keynes’s ideas. In some cases, the apparent ineffectiveness of Keynesian policies encouraged a belief that such policies had not been of much importance or relevance even in the 1950s and 1960s. Kasper et al., for example, in addition to claiming that 'Keynesian demand management is now dead' and that Keynesian policies, 'far from curing the problem of demand deficiency, may now actually worsen it', argued in 1980 that: 'The apparent inability of traditional Keynesian prescriptions to lead us out of the economic bog suggests that the apparent success of those measures in the 1950s and 1960s

3 J.O. Stone, 'Inflation and the International Monetary System', IPA Review, Vol. 23, No. 2, April-June 1969, p. 61. This was a reprint of an address given at Ohio State University in February 1969.
may have relied more heavily on underlying, non-Keynesian features of economic activity than we appreciated.  

The appearance and persistence of stagflation had a particularly devastating effect on the economics profession. As noted in Chapter Three, during the 1960s Keynesianism became associated with the phenomenon known as the Phillips curve. The curve became the symbol of economic control. During the 1960s the term 'fine-tuning' came into vogue. This phrase captured the confidence economists had in the ability of governments (and more particularly themselves) to adjust the economy in a wholly predictable manner with only a small margin of error. When the Phillips curve disintegrated so too did the self-assurance of the economics profession. Confidence gave way to pessimism and uncertainty. Keynesianism, it seems, was a victim of the backlash.

Even Samuelson, the stalwart of the neoclassical synthesis, lost some of his former confidence; his belief that cyclical fluctuations were no longer of much relevance and his faith that fiscal and monetary policies could be used to maintain high levels of employment, had been severely weakened by the mid-1970s. In the 1976 edition of *Economics* he argued that 'we end with the reasoned prospect that appropriate monetary and fiscal policies can try to recreate an economic environment which will validate the verities of microeconomics'. The argument now was that economic policies can try to maintain high employment. In the 1950s and 1960s the

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belief was that such policies would create such a state. Samuelson believed that policies could be used to avoid 'the worst excesses of boom and slump'. Stagflation, however, was an 'unsolved problem'.

Loss of confidence was not restricted to the economics profession: it was community wide. But the lack of confidence experienced in the community at large was not just because of the evident breakdown of the Phillips curve, because inflation and unemployment were now coexistent. Rather, it was because inflation and unemployment had achieved, and were being maintained at, levels which were completely alien to post-war experience. The unemployment figures in particular represented a significant break in trend. From 1945 until the early 1970s the annual rate of unemployment in Australia fluctuated between 1 and 1.5 per cent per annum. Only in 1952-53 and 1961-63 did it exceed the higher figure. Even then the highest level attained was the 2.5 per cent experienced in 1961-62 (with a peak of 3.1 per cent being attained in January 1962). During the 1960s Australia was dubbed the 'lucky country', being matched only by West Germany for its record of low unemployment and low inflation. After twenty-five years of continuous high employment and sustained high levels of economic growth, the community had come to believe that continuous advance, continuous progress, was not only possible but probable. The events of the 1970s severely damaged this belief. This was particularly so in Australia's case because, as Peter Sheehan points out, 'Australia has had lower growth, very much higher unemployment and somewhat higher inflation than OECD countries as a whole over the six years to 1979.'

6 Ibid.
7 Peter Sheehan, Crisis in Abundance, (Penguin, Ringwood, 1980), p. 16.

387.
1975 unemployment in Australia was in excess of 4 per cent. By 1978 it had reached 6 per cent. With the break-down of what had come to be regarded as normality, it was perhaps not surprising that orthodoxy should come under attack. When the world does not perform predictably traditional methods of economic management are likely to bear the brunt of the blame. After its revolutionary origins during World War II, Keynesianism had become orthodoxy. Just as the orthodoxy of the 1930s came under increasing attack in the face of mounting unemployment, so too the Keynesian orthodoxy of the 1970s. A community oriented toward success does not tolerate perceived failures.

Another reason for the growing dissatisfaction with Keynesianism, one which had been brewing throughout the post-war period, was that underpinning the belief that the government could and should regulate the economy was an important assumption: that there exist bureaucrats with enough impartiality and skill to know when and in what ways to use the policy weapons available to the government. The standard example is the proposal to expand public expenditure when unemployment threatens. There are a number of problems, however, in implementing such a strategy. Policy advisers have to know how much to change, say, taxation or public expenditure and they have to know when to introduce these measures. There is the additional problem that the government, for political reasons, may not be willing to do what its policy advisers suggest. Thus, a difficulty with the Keynesian notion of economic control is that measures may be introduced too late and then possibly too severely. A number of examples can be given of instances when governments were in error in the timing of their measures. The 1951 Horror Budget was introduced after the boom had already passed its peak. Similarly, the package of measures introduced in November 1960 was applied too late. In both instances, because of
incorrect timing, government action had the effect of intensifying the
downswing. Because of political considerations measures, particularly
those to deal with inflation, may not be introduced at all. It is also a
possibility that quite inappropriate measures may be introduced because of
an impending election. A good example was Billy Snedden's overly generous
budget of 1972, just prior to the election of that year, which gave far too
much stimulus to an economy which was already suffering from a bout of cost
inflation.

Keynesianism fell out of favour also because of the fact that it
was associated with 'stop-go' policies. The rationale for stop-go policies
provided by Keynesians was that economic conditions are continuously
changing and policies therefore must also change. The argument raised
against this was that stop-go policies were detrimental to business
confidence in that they created uncertainty: it was claimed that if the
government kept changing company tax rates or the types and scales of
deductions, or kept varying interest rates, it was difficult for firms to
plan their investments. Moreover, at times discretionary policies led to
the belief that the government did not really know what it was doing and
this, too, it has been argued, had the effect of upsetting business
confidence. Although such criticisms have been made since the 1950s, they
were to be given fresh significance in the 1970s when the Whitlam
Government alternated between a severe monetary squeeze and strong
stimulatory action.

Another reason why Keynesianism fell out of favour, and which was
of particular relevance during the 1970s, relates to the fact that the
adoption of Keynesian policies led to the abandonment of balanced budget
principles. In pre-Keynesian days it was believed that it was the duty of
governments to balance their budgets annually; it was the duty of governments to make sure that they did not spend more than they expected to receive in revenue. From a Keynesian perspective, however, the idea of balanced budgets is an anachronism. Instead, it is argued that the government's actions should be determined by the state of economic activity. The aim is not to balance the budget but to balance the economy. However, an ever more vocal complaint raised throughout the 1970s was that the abandonment of the balanced budget principle had given licence to unrestricted government spending. Because governments no longer had to worry about matching revenue with expenditure, they had been able to go on a spending spree. In other words, it was argued that Keynesianism led to the abandonment of financial responsibility. In Australia, Gough Whitlam's Prime Ministership encouraged such attitudes. There was evident concern not just at the ever-widening budget deficit of the Whitlam years but at the large absolute increases in governmental expenditure which occurred during that period. Prime Minister Malcolm Fraser was able to use this concern to great advantage.

The fact that Keynesianism became associated with ever-increasing levels of governmental expenditure gave rise to other complaints. One was the crowding-out hypothesis. This argument has taken a number of forms. In a situation in which resources are fully employed, for instance, an increase in public expenditure can only be achieved by denying resources to the private sector. Such an argument, a variant of the 'Treasury View' of the inter-war period, became a frequent complaint during the Whitlam

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8 This argument is dwelt on at length in James M. Buchanan and Richard E. Wagner, Democracy in Deficit: The Political Legacy of Lord Keynes, (Academic Press, New York, 1977).
years. Crowding-out may also occur in financial markets: in order to finance its deficits it will be necessary for the government to compete with the private sector for funds. Increasing deficits, it is held, mean less funds are available for the private sector. In this way, too, the private sector is crowded-out. Such crowding-out necessarily means not only a slower rate of growth (the propensity of the private sector to contribute to output growth is assumed to be much greater than that of the public sector) but also a less vigorous, less dynamic, less efficient economy. Persistent deficits, monetarists insist, have the additional undesirable effect of increasing the money supply and thereby pushing inflation higher. Again, the policies of the Whitlam Government have been held to prove the existence of this causal connection.

Another complaint raised against the consistently upward trend in the level of government expenditure in the post-war period, and in the 1970s in particular, was that such a trend necessarily entailed successively higher levels of taxation. During the 1970s there was a widespread reaction against what were perceived to be unjustifiably high levels of taxation. Perhaps the most famous symbol of this dissatisfaction and agitation was in the form of the Californian tax revolt which pressed for an immediate and considerable reduction in the level of the local taxation charge on property.

In short, Keynesianism became associated with a belief that governments were spending too much, taxing too much, and interfering too much with the workings of the economy. This prompted calls for an alternative system in which government spending and taxation are progressively reduced and in which consumers and producers are less fettered by governmental regulations. It is here that the links between
the neoclassical resurgence and the rise of neoconservatism can be seen most clearly.

By providing policy makers with tools and concepts to iron-out boom-slump cycles, Keynes himself contributed to the rejection of his own theoretical arguments. Minsky puts the point well:

In economics if history over a thirty-year period does not cast up observations with at least a family resemblance to a financial panic or a deep depression, then arguments to the effect that these anomalies are myths, or that what happened can be explained by measurement errors, human (policy) errors, or transitory institutional flaws which have since been corrected, may be put forth and gain acceptance. That is, the view arises that the disturbing problem that established a need for a new theory 'never' really occurred. Thus an economic theory based upon a business cycle associated with a financial-instability view of how the economy operates can be replaced by theory with a steady-growth perspective, because the relevant considerations to substantiate the cyclical, financial-instability view cannot be made. This is what took place as the forties, fifties, and sixties spun their tales of war and apparent economic success - a success achieved without the aid of appropriate monetary and fiscal policy.9

Certainly within the Treasury, particularly among younger officers, the relative stability of the post-war period had a marked impression on the way the economy was interpreted. As the post-war period continued, the belief that the economy was self-adjusting gained strength. As noted in Chapter Seven, by 1966 the Financial and Economics Surveys Division could dismiss the depression experience as no longer relevant. The dismissal of the depression experience became part of a broader belief, following Minsky, that the depression was in fact an anomaly, not an inherent defect. Any notable disturbances, such as 1961-62, could be rationalised by blaming not the system but policy mishandling. It is interesting also to note the growing debate in the 1960s on how important policy initiatives

had been in the continuance of buoyant conditions. The view became increasingly popular, and not just among monetarists, that stabilising policies had in fact been destabilising. Dow's verdict in 1964 on post-war British anti-cyclical policy, that 'as far as internal conditions are concerned ... budgetary and monetary policy failed to be stabilizing, and must be judged to be positively destabilizing', came to be widely accepted - as Worswick puts it, Dow's view 'found its way into conventional wisdom'.

The persistence of full employment conditions throughout most of the post-war period not only encouraged a belief that the economic system was self-adjusting but also directed attention to the relative scarcity of resources. It is here that the question of why Keynesianism was abandoned merges with that of why neoclassicism takes its place. Interest in resource scarcity was encouraged also by the growthmanship which prevailed in the 1950s and the 1960s. The widespread anxiety to increase the rate of growth of GNP led to discussion of the conflict between consumption and investment. In the 1950s and 1960s the problem of labour scarcity was a key concern. By the end of the 1960s, highlighted by the burgeoning 'limits to growth' debate, the question of environmental despoliation and imminent exhaustion of natural resources became a matter of keen interest. In the 1970s the policies of OPEC, the oil embargo in particular, attracted even greater attention to the issue of resource scarcity. The problem of scarcity focussed attention on efficient resource

allocation which directed attention to the pricing mechanism which in turn raised issues of 'rational' economic behaviour. Full employment of resources was assumed. The question of what determined aggregate demand receded into the background. Thus, the persistence of full employment not only directed attention away from Keynes's theoretical analysis but turned it instead toward the classical framework.

Sustained full employment also directed attention toward the problem of inflation. The post-war period was an age of persistent inflation. By the early 1970s 'creeping' inflation gave way to 'galloping' inflation. With the persistence of inflation and with the marked increase in trend, monetarist analysis became steadily more popular. Keynesians paid the penalty for years of indifference toward the problem of inflation. Some had dismissed it as part of the Phillips curve trade-off outlook as the inevitable cost of high employment. In some cases, such as the Report of the Radcliffe Committee in 1959, so-called Keynesians insisted that money did not really matter. Monetarists, true to their name, not only argued that money did matter but had for long been arguing that inflation was the chief threat to the capitalist system. Milton Friedman sparked widespread interest in monetarist ideas by maintaining in December 1967 in his presidential address to the American Economics Association that the Phillips curve analysis was faulty in that it ignored expectations. He claimed that a trade-off between inflation and unemployment could only occur in the short-term. In the long-run, higher inflation would be associated with higher unemployment. With the breakdown of the Phillips curve shortly after, Friedman's prestige could not help but increase. His theory of inflationary expectations provided an explanation, and policy cure, for stagflation - something which Keynesian analysts then seemed unable to do.
Just as emotional turmoil is a powerful inducement to accept the simplicities of religion, so too did the confusions, contradictions, complexities and consternation aroused by the events of the 1970s make the simplicity, the neatness, the tidiness, and the determinancy of neoclassical economics increasingly attractive. It is interesting in this respect that in the 1973 Survey, when the Treasury was beginning to ask whether the Phillips curve was dead, it was argued that inflation was a complex problem requiring the adoption of a variety of weapons to tackle it successfully. The department declared: 'for practical people, concerned with reducing inflation, simplistic models and the simplistic prescriptions which flow from them are not helpful'. By 1977, however, John Stone was advocating the use of what he referred to as 'simplicities' as a way of coping with the perplexing nature of the economic world. Stone confessed that: 'The more I've had to live with the sort of situation we have been experiencing the more I have been driven to the view that one had better cling on to some simplicities if only because the more complex prescriptions are not particularly helpful.' He maintained that since 1975 there had evolved in the sphere of domestic policy 'a set of simplicities', described by some as over-simplicities, which had been 'broadly right'. The most important of these he referred to as 'the most overwhelmingly simple simplicity' - this being that real wages had to be brought back into line with productivity. Similarly, a pervading theme of the rational expectations literature which burgeoned in the 1970s was an evident delight in the simplicity of the rational expectations theory and an air of

incredulity that such an 'obvious' and 'self-evident' idea had not been explored before. McCallum, for example, argues that the main reason for the success of rational expectations was that 'the basic idea of the hypothesis is simply that economic agents behave purposefully in collecting and using information, just as they do in other activities, an idea that it is hard for an economist to reject without considerable embarrassment'. 12 Similarly, Cagan argues that 'rational expectations has rapidly gained attention because it is so natural and appealing. It must make its opponents furious, because, absurd as they think it is, to attack it is to appear to deny that behaviour is rational.... Indeed, it is so appealing that one wonders why it took so long to develop.' 13 To some rational expectationists, the acceptance of the theory was akin to religious conversion. This can be seen, for example, in an article by Mark Wiles who claimed that as a result of rational expectations 'a fleet of stunned Keynesians is quibbling about which of their few remaining fish are still flopping'. With decidedly 'confessional' overtones, the neophyte admitted: 'I know how they feel, for I once believed in conventional, Keynesian theory and the economic models based on it. Now, however, I am persuaded that this theory is fundamentally wrong, so wrong that it can never yield adequate models for evaluating policy.' 14


These considerations lead into a point of fundamental importance. In a world in which Keynesian economics was indelibly associated with the long-dead Phillips curve, in which inflation was rampant, in which governments seemed to have lost their ability to manipulate the economic system and guarantee full employment, in which there was community restlessness, agitation and an incessant clamour for higher wages, improved services and facilities and higher living standards, in which traditional values were being challenged, in which war threatened and spending for defence purposes sharply increased, and in which public expenditure was burgeoning, in such a world neoclassical economics became increasingly attractive. For neoclassical analysis offered not only simplicity but more importantly order, harmony, obedience. Its underlying attraction was that it offered authority without having to resort to dictatorship. The market ruled. It disciplined economic agents. It operated inevitably, inexorably, implicitly and explicitly. The force of the market could not be denied. One could try to override market forces but one would merely subject oneself, to use a favourite Treasury expression, to 'unnecessary costs', 'unnecessary pains'. In short, a key reason why the neoclassical resurgence occurred was that it offered order in a world which had most certainly become disorderly.

Another important consideration is that, as argued in Chapter Three, the revolutionary elements in the theoretical core of the Keynesian model - the assumed absence of self-adjusting tendencies, the denial of the rational, calculating image of man, the concern with historical rather than logical time, and the use of causal rather than equilibrium models - never gained widespread acceptance or understanding within mainstream economics.

It would seem that the Keynesian mode of thought is in many ways
contrary to Anglo-Saxon culture, thereby placing a persistent and seemingly
insurmountable obstacle in the way of those attempting to secure
understanding and acceptance of Keynes's approach to economics. The
Keynesian vision of contingency, partial indeterminacy, and historical
time fits much more closely into the French and German traditions with
their emphasis on interrelations and on the need for a holistic approach to
economic and other forms of social behaviour. Neoclassicism, by contrast,
is in fundamental accord with the Anglo-Saxon tradition, which favours
individuality, control and order and which translates this general cultural
preference into an epistemology stressing the need to amass objective,
empirically verifiable facts as a basis for clarifying the logical,
mechanistic, deterministic forces underpinning the actions of the
individual members of an essentially atomistic society.

It is interesting in this respect that in the United States, where
individualism is revered much more than equality, Keynesianism was
generally greeted from the start with reservation if not sometimes outright
rejection; a prejudice reflected in the popularity there of monetarism and
rational expectations theory. This leads into a related point: it is
clear that the neoclassical resurgence is linked directly with the
domination of post-war economics by Americans; a domination clearly seen at
the research level in the proliferation of papers, articles and texts
written by Americans since the 1950s. Although neoclassicism has never
been as strong in Australia as it is in the United States the influence of
the latter on the trend of Australian economic thought is obvious. It can
be seen, for instance, in the popularity of American economics texts in
Australian universities (particularly at Monash and the ANU) and in the
increasing popularity of undertaking post-graduate study in the United
States. It is also interesting in this respect that since the early 1960s
an increasing number of officers from the Australian Treasury have been seconded to Washington-based institutions such as the IMF and the World Banking Group. At the IMF Treasury officers have been employed at a variety of levels, including executive director (Stone and O'Donnell being examples), alternate director, economist and technical assistant. Some of the younger officers have participated in the Young Professionals Programme of the IMF. Thus, the American influence has been experienced both indirectly and directly.

In understanding why Keynes's theoretical revolution was aborted it seems he was a victim of his own methodological indifference, his relative unconcern at how his ideas were expressed. As he explained in 1937:

I am more attached to the comparatively simple ideas which underlie my theory than to the particular forms in which I have embodied them, and I have no desire that the latter should be crystallised at this stage of the debate. If the simple and basic ideas can become familiar and acceptable, time and experience will discover the best way of expressing them. 15

It seems that this was a mistake on Keynes's part. As Remenyi points out,

In economics a successful revolution seems to require the emergence of a powerful artifact. Smith's division of labour, the Marshallian cross, the Edgeworth box, Robinson/Chamberlin tangency solutions in monopolistic competition, and Samuelson's axiomatic approach to revealed preference are cases in point. Keynes' failure to overthrow the neoclassical SRP [scientific research programme] may well lie in his failure to challenge or provide an alternative artifact to the neoclassical, core-supporting, 45-degree diagram and the Hicksian IS-LM synthesis. 16

Linked with this, Keynes made many concessions to classical


analysis. As Minsky points out, 'Like so may other seminal and original works, The General Theory is a very clumsy statement. Much of the old theory is still there, and a great deal of the new is imprecisely stated and poorly explained.' 17 Perhaps Keynes's most serious concession was a passage in the final chapter of the General Theory:

if our central controls succeed in establishing an aggregate volume of output corresponding to full employment as nearly as is practicable, the classical theory comes into its own from this point onwards. If we suppose the volume of output to be given, i.e. to be determined by forces outside the classical scheme of thought, then there is no objection to be raised against the classical analysis of the manner in which private self-interest will determine what in particular is produced, in what proportions the factors of production will be combined to produce it, and how the value of the final product will be distributed between them. 18

Joan Robinson is quite correct in pointing out that here was the neoclassical synthesis, or bastard Keynesian, theory 'in its purest form'. 19 She is correct also in arguing that such remarks were 'ill-considered' and, more importantly, 'quite contrary to [Keynes's] main argument'. 20 Passages such as the above add weight to Minsky's suggestion that:

in interpreting The General Theory to determine what is vital and what is not essential to the radical revision Keynes believed he was formulating, it is necessary both to prune away concessions made to the old - concessions which either inadvertent, due to the hold of the old over Keynes's thought processes, or consciously opportunistic, due to Keynes's desires to speed the adoption of correct policy, if not of

20 Ibid., p. 127.
correct analysis - and to extend, complete, and draw further inferences from the innovative elements.\textsuperscript{21}

Such pruning, however, has only been done rarely. As Robinson points out, the 'very mollifying style' of the last chapter of the \textit{General Theory} 'made it possible for orthodoxy to accept it and to pass very lightly over the awkward questions that earlier chapters had raised'.\textsuperscript{22}

Minsky has made another valuable suggestion as to why Keynes's theoretical revolution was aborted: the fact that Keynes played only a minor part in the interpretative debate that followed the publication of the \textit{General Theory}. Minsky compares Keynes with intellectual revolutionaries, such as Marx, Darwin, Freud and Einstein, who were able to perform a crucial and sustained role in elucidating, elaborating and refining their revolutionary but rough seminal ideas:

They participated fully in the transition from the clumsy original to the better, more elegant, and polished statement of the new theory. They were around to point out that an interpretation had not gotten something quite right, that a particular bit of evidence showed exactly what they meant, and that the new concepts had implications beyond those recognized in the initial statement.\textsuperscript{23}

Such opportunities were denied to Keynes. A heart attack suffered early in 1937 severely limited his participation in the debate aroused by his book.\textsuperscript{24} When his health had recovered sufficiently to resume active work (his health in fact never recovered fully), World War II had begun and it

\begin{itemize}
  \item \textsuperscript{21} Minsky, \textit{Keynes}, p. 13.
  \item \textsuperscript{22} Joan Robinson, 'The Disintegration of Economics', in Robinson, \textit{Collected Economic Papers}, Vol. 5, p. 93.
  \item \textsuperscript{23} Minsky, \textit{Keynes}, p. 13.
  \item \textsuperscript{24} However, Keynes did manage to write a number of important, albeit brief, papers which clarified his ideas. These were referred to in Chapter Three.
\end{itemize}
was the practicalities of wartime economic policy to which he devoted his energies. With the war barely over, Keynes suffered another, this time fatal, heart attack. The way became clear for the ISLM framework and the neoclassical synthesis, with only minor opposition, to assume the ascendancy.

But perhaps the key consideration is the fact that the revolutionary elements in the Keynesian model, when taken to their logical conclusion, would have made equilibrium economics untenable. This in turn would have robbed economics of its determinancy and threatened the deeply cherished pretensions of economists to model themselves on the natural sciences. Such threats could not be tolerated. There was too much at stake. In Lakatosian terms, Keynes threatened the neoclassical hard core and thereby set off a variety of defence mechanisms. 25

Initially, the threat posed by Keynesianism was met by supposed reconciliation; the neoclassical model was modified by incorporating in it some of the features of the Keynesian. Thus, as early as 1937 Hicks had modified the General Theory to fit it into a determinate equilibrium framework. The expurgated version of the book, in the form of the ISLM diagram, was accepted widely and was assumed to be faithful to the

25 Remenyi identifies two broad categories of defence mechanisms: the errant hypothesis factor and the institutional response factor. These translate into at least forms of action to deal with potentially competing scientific research programmes, such as '(i) critical examination of the methodology used by recalcitrants to reject core-supporting hypotheses and/or metaphysical beliefs and heuristics; (ii) construction of core-supporting counterexamples or experiments which reject the rival; (iii) added theoretical work to incorporate the raison d'être of the rival theory into hard-core supporting models, often as special cases of the dominant SRP'. See Remenyi, 'Core Demi-Core', pp. 51-2. For a specification of the neoclassical hard-core, see pp. 55-61.
original. It was praised for neatly demonstrating the interaction between real and monetary variables. The real-balance effect also served to counter the threat to determinate equilibrium theorising by supposedly showing that the system ultimately was self-adjusting. But again an effort was made at reconciliation: Patinkin and others were happy to concede that Keynesian policy initiatives were necessary to hasten the restoration of full employment equilibrium. Geoff Harcourt points out that throughout the post-war period Friedman has been engaged in a process of dismantling piece by piece those elements of the Keynesian framework which had been accepted by mainstream analysis:

Friedman's life work may be seen from one aspect as a concerted effort to pick off, decade by decade, the principal props of Keynes's system - the rival consumption functions; the relative impact of money versus investment on overall activity and prices; the liquidity preference theory of interest versus Friedman's capital theory; monetary versus fiscal policy; the relative importance of balance sheet vis-à-vis income and expenditure accounts; and so on. He wishes to reveal the so-called Keynesian revolution as an abortive aberration in the mainstream of economic theory and, incidentally, make the world safe for free men. 26

But again Friedman's method was to claim (or at least concede) that he was modifying and incorporating, and not wholeheartedly rejecting, the Keynesian model - indeed Harry Johnson points out that an essential prerequisite for the success of the monetarist counter-revolution was that it produced 'an apparently new theory that nevertheless absorbed all that was valid in the existing theory while so far as possible giving these valid concepts confusing names'. 27


Beginning in the late 1960s the neoclassical hard core was defended by rejecting Keynesianism outright. In the 1970s rational expectations theory effectively restored the concept of perfect knowledge, went so far as to claim that market-clearing situations were the norm - thereby rejecting any notion of involuntary unemployment, and maintained that discretionary policies were not only self-defeating but positively harmful. It is clear that the association of Keynesianism with the Phillips curve provided the ideal means for the open rejection of Keynes's model. For the collapse of the Phillips curve, as noted, allowed monetarists and rational expectationists to claim that the weaknesses in Keynesianism were now patently obvious and undeniable and that there was an evident need for an alternative and supposedly more realistic theoretical framework.

There are serious doubts, however, whether monetarism and rational expectations can really claim to be more realistic than competing theories. On the contrary, it seems that one of the chief characteristics of the economics of the neoclassical resurgence is its short-sightedness, if not blindness. Just as classical and neoclassical economics developed in reaction to rapid economic growth and the social dislocation caused by sudden and pervasive industrial and technological change, so too did the neoclassical resurgence reflect the rapid growth and concomitant technological, scientific, industrial and social changes of the post-war period. Both theoretical developments responded to this change by attempting to turn the clock back, in that they preached the benefits of a market mechanism that was either non-existent or severely constrained. And both stressed the need for self-discipline, order, control and rationality but failed to come to grips with the fact that such ideals are inevitably eroded by affluence. One can wonder, too, whether it is perhaps naive...
(leaving aside questions of morality) to believe that a rise in unemployment will in fact breed subservience; the evidence suggests that it breeds resentment, discord and rebelliousness, certainly not discipline. It seems that there is a lesson to be drawn from countries such as Japan and West Germany with their greater social equality and their emphasis on social co-operation. The economic performance of these countries in the face of the economic difficulties experienced in the 1970s stands in stark contrast to that of the United States, Great Britain and Australia where the policy pursued has been to increase inequality.
The bibliography is set out as follows:

1. Official: (a) Treasury; (b) Other
2. Books
3. Articles, Papers, Pamphlets and Addresses
4. Newspaper Articles
5. Unsigned Articles (set out in chronological order)

1. **Official**

(a) **Treasury**

The most important source of information on Treasury thought are the annual Economic Surveys, published from 1956 to 1973. The first two surveys were entitled as follows:

Australia, 1956: An Economic Survey;
1957 and Beyond: An Economic Survey.

In 1958 the title was changed to:
The Australian Economy, 1958.

The surveys retained this title form thereafter with of course the name of the year being changed. All were published by the Commonwealth Government Printer, Canberra.

During the mid-1960s the Treasury published a spate of Supplements to the Treasury Information Bulletin, all of which provide important insights into Treasury thought. The most important supplements were:

The Meaning and Measurement of Economic Growth (November 1964);
Projections of the Work-Force, 1963-76 (April 1965);
Private Overseas Investment in Australia (May 1965);
The Australian Balance of Payments (February 1966);
Investment Analysis (July 1966).

In the early 1960s the Treasury also began publishing a series of supplements entitled:
National Accounting Estimates of Public Authority Receipts and Expenditure.

These appeared at regular intervals (usually biannually) throughout the 1960s. These documents occasionally contained interesting sections of relevance to an understanding of Treasury thought, such as section 5 in the August 1966 Estimates supplement which discussed the budget and the level of demand.

In the second half of the 1960s the Treasury began to publish a cursory discussion of the economic context in Statement No. 1 attached to the annual budget speech. In the early 1970s this discussion became enlarged and became a separate statement, entitled:
Statement No. 2: The Budget and the Economy.
In the second half of the 1970s this became a lengthy and detailed document and a key source of insight into the department's ideas.

Also in the early 1970s, the Treasury ceased publication of the Treasury Information Bulletin, replacing it with Round-Up of Economic Statistics. A number of brief supplements have been appended to the Round-Up dealing with technical issues such as measuring inflation and measuring the real wage overhang. These supplements are of some use in indicating the direction of Treasury thought but for the purposes of this thesis are not particularly important.

The Supplements to the Treasury Information Bulletin were replaced by a series called Treasury Economic Papers. The first two papers were published in 1972 and 1973 under the following titles:

- Overseas Investment in Australia (1972);

Both were published by the Commonwealth Government Printer, Canberra.

The department did not resume publishing TEPs until 1978. Since then the department's output has increased markedly, as shown in the following list:

- Flexibility, Economic Change and Growth: Treasury Submission to the Study Group on Structural Adjustment (1978);
- Jobs Markets: Economic and Statistical Aspects of the Australian Market for Labour (1978);
- Energy Markets - Some Principles of Pricing: Treasury Submission to the Senate Standing Committee on National Resources (1979);
- NIEO: An Assessment of the Proposals for a New International Economic Order (1979);
- Technology, Growth and Jobs: Treasury Submission to the Committee of Inquiry into Technological Change in Australia (1979);

Since the completion of this thesis the Treasury has published TEP No. 9:

- The Australian Financial System: Treasury Submissions to the Committee of Inquiry into the Australian Financial System

All were published by AGPS, Canberra.

In this thesis use was made of the submissions on the Australian financial system as they appeared in mimeo form. Nine papers were submitted, published between 1979 and 1980.

Between 1974 and 1975 the department published fifteen Treasury Taxation Papers, numbers 1 to 13 being submitted to the Taxation Review Committee during 1973 and 1974, and numbers 14 and 15 being submitted to the Committee of Inquiry into Inflation and Taxation early in 1975. Some of these papers were useful for providing insight into the department's ideas on discretionary economic policy. Particularly relevant in this regard were numbers 4 and 14:

- Personal Income Tax: The Rate Scale (October 1974);
- Indexation of the Personal Income Tax System (July 1975).

All were published by AGPS, Canberra.

Another document of use in understanding the department's views on the rules versus discretion debate was:


This was published by AGPS, Canberra.

The other main source of information on Treasury thought is of course the
annual budget speech and the various financial statements issued by the Treasurer. While the Treasury is not always responsible for the policy decisions announced in these documents, it does have the responsibility for drafting the sections concerned with economic conditions. Budget speeches, financial statements and ministerial statements from the mid-1930s up to the present have been consulted for the purposes of this thesis.

Finally, two miscellaneous (in the sense that they do not belong to a series) but important documents written by the Treasury are:

- Taxation and the Economy. Commonwealth Government Printer, Canberra, 1948; and

For information on the staffing and structural arrangements of the department, the (near) annual Federal Guides, now Commonwealth Directories, are invaluable.

The department did not begin issuing annual reports until 1979. These have appeared annually since then and provide information on staffing and structural matters, the functions of the various divisions, the activities of departmental officers (such as appearances before Commissions and Committees), and list the various Treasury publications and those of individual officers in the relevant year.

The Treasury's Submission to the Royal Commission on Australian Government Administration (November 1974) was a lengthy and detailed document of great use in understanding how the department saw its role. A series of attachments to the submission were a valuable source of information on the educational qualifications of Treasury officers.

Those papers written by individual Treasury officers and used in this thesis are listed in section 3 of the bibliography.

(b) Other


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