1. The triumph of the economists?

In 1981, Colin Clark wrote to the Cambridge economist Joan Robinson suggesting that he had found a telling insight into J. M. Keynes and the evolution of some of his thought that was later embedded in *The General Theory*.¹ In 1932, Keynes had written an appraisal of the economic response by Australian authorities to the Depression. Somewhat uniquely guided by economics expertise, the authorities had responded with an orchestrated mix of cost-cutting, fiscal austerity and a modest form of monetary expansion. Asked to review Australian economic policy, Keynes demurred on the idea of further wage cuts or indeed devaluation, suggesting that Australia wait for an internationally coordinated response to revive economic activity. He suggested greater recourse to public works. That advice, as we shall see, did not entirely please Australian economists.

Keynes once remarked that there had been ‘few passages in the history of controversy more valuable…than that which took place among economists in the ten years…before the war’.² This study directs attention to Australia and her economic profession. By the eve of World War II, Australia’s small community of academic economists had been swept along by the Keynesian tide. A new vista of managing the economy was at hand. Aside from the intellectual activity Keynes’s *General Theory* stirred among Australia’s economists, they had long been articulating the need for greater control over the economy before World War II broke out. During the 1930s, relations between Australian economists and the federal government had wavered between considerable relevance and quiet neglect. In 1931, economists and politicians came together to frame a cohesive and unique policy response to the Depression within Australia. That outcome, the ‘Premiers’ Plan’, was an attempt at economic experimentation that its prime architect, Douglas Copland (1937a:409), billed as ‘constructive deflation’. This plan was hurriedly designed to meet the country’s need for financial rehabilitation and structural readjustment. At that point, the Premiers’ Plan led the world in economic experimentation against the slump; it elicited intellectual curiosity and scholarship from afar (MacLaurin 1936; Dow 1938; Hawtrey 1934; Garnett 1949). It was acknowledged that Australia was one of the first countries to appoint a ‘brains trust’ of economists, with some degree of executive authority to help guide the nation out of its difficulties (Goodwin 1974:235).

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¹ C. Clark to J. Robinson, 14 May 1981, Colin Clark Papers, University of Queensland.
² J. M. Keynes to E. Durbin, 1942, Keynes Papers, King’s College, Cambridge (hereafter, KPKC).
Only a short time before, economists had neither the plan nor the authority to deal with Australia's peculiar economic difficulties. The Premiers' Plan was, by necessity, a politically inspired one with events pushing economists to the forefront. In private, Copland referred to it, with good reason, as 'the economists' plan', but it was politicians who had to implement it. It was not long before economists grew concerned that economic policy settings were too deflationary and preoccupied with the external account. It was also the case, though, that as the economy slowly recovered the less inclined were the authorities prepared to turn, again, to economists. On the whole, Australian economists did, however, make inroads into the world of policy advice during the 1930s. By 1938, for instance, Australia's central bank, with economists in the backrooms, dealt effectively with the threat of an internationally transmitted downturn known as the Roosevelt recession. The year after, economists—with some now serving in a semi-official capacity—had further success with a plan to facilitate Australia's war preparations without causing undue economic disruption. Why was it, then, that Australian economists were becoming more influential with policymakers? The answer was not just they had always been a policy-focused profession but, more importantly, their advice sprang from new economic ideas.

This gulf between economists and politicians is, of course, hardly a unique occurrence. Policymaking is renowned for being an intramural, opaque process with many divergent interests impinging on it. Politicians rarely look to economists to tell them what to do; rather economists, as with the Premiers' Plan, usually provide rationales for action or inaction (Harcourt 1986). The predominant new paradigm of economic thought in the 1930s was the birth of macroeconomics. Keynes's *General Theory*, once understood, made economists energetic in calling for greater ambition in managing an economy. The failure of Keynes to win much policy ground in Britain during the late 1930s has been well documented (Peden 1988; Middleton 1985; Tomlinson 1984; Skidelsky 1992). Even Keynes despaired of it. Treasury officials in Britain would prove too sceptical, by nature and training, to be swept along by a 'revolution' in economic theory until the outbreak of war changed this (Peden 1988:120).

When policymaking institutions in Britain did display an acceptance of Keynes's *General Theory* it was usually muddied, ambivalent or incomplete (Bridges 1964). While Keynes's ideas and theories might have swept through the cloisters, the corridors of power proved a harder nut to crack. The diffusion process was held back by circumstances, bureaucratic inertia, the climate of opinion and, not least, the nature of the ideas themselves. It was only when Keynes entered and worked at the British Treasury during World War II that his ideas found application in policy. Even then, a little known memoir of him recalls that Treasury officials still felt that Keynes did not seem fully aware of the recalcitrance and intractability of the political process (Le Pan 1979:83).
The triumph of the economists?

The transmission of Keynes's ideas into the Australian political mainstream, in contrast, was smoother and innovative—attributable to the useful start economists had made in establishing a rapport and credibility with government leaders in the 1930s. Australia seemed fertile ground for authentic Keynesian economics to take root, though not necessarily in officialdom (Markwell 1985; Smyth 1994; Turnell 1999). One commentator described Australia as 'the utopia of practical economists' (cited in Goodwin 1974:236). Apart from the avowedly public orientation of their profession, economists also owed their influence to the fact that economic policy was not entirely within the Australian government's ambit. Four extra-parliamentary agencies—namely, the Arbitration Court, the Tariff Board, the Commonwealth Bank and the Australian Loan Council—exercised a 'quadripartite control of industrial and financial circumstances' (cited in Brown 1994:91).

As the Commonwealth assumed greater executive command over the shaping of monetary and budgetary policy, academic economists were replaced, to some extent, with 'inside economists' (Corden 1968). They were, however, still cut from the same cloth. In international forums, too, Australian economists had gained pre-eminence by adopting a proto-Keynesian stance for restoring balance to the global economy (Turnell 1999). More importantly for our purposes, Australian economists were freshly apprised of the latest developments in economic theory and practice.

Against what would become the dazzling light of economic reason stood a federal government comfortable with the recovery achieved by economic readjustment and fiscal consolidation. Notorious for its 'let business alone' stance, the three Lyons governments that ruled from 1932 until 1939 were prone to intellectual torpor (Hart 1967). Throughout the 1930s, academic economists, in a bid to change the climate of opinion, made representations to politicians directly and via the press. On balance, as many overseas commentators noted, Australian economists were quite influential with policymaking authorities relative to their overseas counterparts. How they achieved that profile had to do with the circumstances facing Australia, together with axioms and conventions that underpinned the economics profession.

The groundwork was already in place, then, which would spearhead Australia's acceptance of Keynesianism. It did not come, alas, with an accommodating 'explicitly altered economic vision' among political leaders (Heilbroner and Milberg 1995:43). The first threads of comprehensive economic management in Australia came with the 1939/40 budget, which put into circulation the Keynesian technique of estimating the inflationary gap (Cornish 1993a; Markwell 1985). The war-finance approach that Keynes (1940) outlined in How to Pay for the War—that is, how to shift resources from civilian to war purposes without incurring inflation—was acted on by Australian economists (Walker 1939b).
The ambit of this book

This book intends to show how the ideas and theoretical thinking of Australian economists, seen through the prism of their policy advice, underwent a major transformation through the 1930s. It will be argued that Australia’s small nucleus of economists was emboldened, as the 1930s wore on, to push for a more informed and more expansionist line on economic activity than hitherto. Economists would have a fundamentally different theoretical and policy outlook in 1939 from that which they had in 1929. The marked change in the theorising and policy advice of the economists during that period was in stark contrast with that of Australian politicians, though there were exceptions. This divergence of opinion between the two groups will be set against the peculiarities of Australian economic experience in the 1930s. This includes not just the slump and protracted recovery but the precariousness of the external account, together with fears of another boom–bust cycle. It will also be set against the economic events that punctuated the period, such as the Royal Commission on Banking Systems and the Treasury bills and funding debates, together with preparations for war.

This book will reveal the process by which Australian economists came to achieve a superior command of Keynesian statecraft arguably earlier than most of their overseas counterparts. It does so by tracing the development in their thought through the years 1929–39. While the study is set within the province of the history of ideas, it is also a study in political economy. That is, it focuses on the complex interaction between economic ideas, events, personalities and policy in interwar Australia. It will closely examine the process Australian economists endured in coming to terms with new ideas on economic philosophy in the 1930s and whether or not they shaped economic policy. The activities and input of economists, expressed through numerous committees, meetings, correspondence and memoranda, will be traced to reveal a conceptual gap between economists and politicians. It will be argued that after being uncommonly influential in 1931, the new conceptual vision of economists, expressly to do with economic management, was frustrated by political inertia, vested interests and complacency. The publication of Keynes’s General Theory in 1936, once understood, fortified the intellectual shift towards economic management. It will examine how, as the first to be liberated from old ways of economic thought, Australian economists went about propagating that new wisdom. Usually their advice fell on deaf ears; the new economic thinking articulating a coherent form of macroeconomic management more distinct and concrete than longings for ‘planning’ raced ahead of political convention and attitudes. This was to become apparent when examining the appropriate economic policy settings for Australia in the late 1930s.
This philosophical shift took some time, of course, to materialise at the official policy level. Some agencies, such as the Federal Treasury—like its British counterpart—remained unmoved by the ‘new economics’ of Keynes. That is, a body of economics with its central focus on the principle of effective demand with policies such as public works, budget deficits and cheap money as the appropriate responses for an economy in slump. Simply put, the new economics of Keynes brought a physical resources perspective to economics. Demand could be safely expanded as long as there was generalised idle capacity in the economy. A commitment to counter-cyclical management of overall demand is too indiscriminate. At a more sophisticated level, it translated not just to the manipulation of aggregate demand but to eschew reliance on market forces to deliver an economy from the slump. While the term ‘macroeconomic policy’ came into circulation only in 1941, Keynes’s emphasis on the aggregate dimension in the *General Theory* marked the effective start of macroeconomics (Clarke 1996:68–9). This study closes by examining the propitious preconditions that underpinned the early acceptance of the Keynesian economic policy in wartime Australia.

### The appeal of this book

The hiatus in Australian economic history from the Depression to World War II—a period of recovery and reconstruction—has been well explored by economic historians (Cain 1980, 1982, 1983, 1984, 1985, 1987a, 1987b, 1988a, 1988b; Schedvin 1970; Sinclair 1974; Clark 1976; Gregory and Butlin 1988). In a series of papers, Neville Cain made a pioneering study of the players, including economists, officials and politicians, behind the formation of Commonwealth economic policy from the Depression through to 1936. No work until now, though, has cogently and systematically looked at how Australian economists moved towards a new constellation of economic ideas in the years leading up to 1939.

Most of the literature on the arrival of Keynesian economics usually dates it from World War II. As the British economist Ian Little (1957:35) put it, ‘Thanks to Keynesian ideas (and the war) the economist has found his way in to government.’ In Australia, it was somewhat different. There was, seemingly, a ‘revelatory’ adoption of Keynes’s *General Theory* by Australian economists (King 1997). Turnell (1999:13) posits that the rapid propagation of Keynesian economics in Australia was because economists had adopted a proto-Keynesian line in the various international forums, together with their unpublished writings, all of which focused on their advocacy for international reflation. In contrast, domestic economic policy was—given the adverse circumstances confronting the economy—more orthodox and deflationary. The Premiers’
Plan became the leitmotiv of Australian economic policy in the 1930s (Turnell 1999:23). This discontinuity between domestic and international strands of Australian economic thought and policy detracts, however, from reaching a true picture of the receptivity of Australian economists to Keynes’s *General Theory*.

This account complements and adds to Sean Turnell’s (1999) unpublished work by showing how Australian economists urged a more expansionist line to domestic policy settings from 1932 onwards. They were not prepared to wait for an upturn in export prices to bring about recovery; nor did the weight of Australia’s external obligations totally circumscribe domestic attempts to reflate. Indeed, the failure of the two major international trade and monetary conferences held in 1932 and 1933 to engineer a global economic stimulus that would lift the export incomes of countries such as Australia forced reliance on domestic expedients. This approach was encouraged and theoretically informed by Keynes, not just with the publication of the *General Theory*, but earlier in 1932 with his incisive review of the policy thinking of Australian economists. For the most part, the federal authorities rejected this expansionist line by Australian economists. The economists did have some success, however, in preventing monetary policy from becoming even more contractionary than it was. There was further recognition of the value of economics expertise when the federal government established a committee in 1938 to expedite the transition to a war economy (Coombs 1981:7).

There are other compelling reasons for this study. In the literature on the spread of Keynesianism across nations, only a handful of studies have touched—and touched lightly—on the reception of the *General Theory* in Australia (Coleman et al. 2006; Cain 1983; Cornish 1993; Markwell 1985; Turnell 1999; Smyth 1994; Whitwell 1994). Cain (1983:21) urged others to investigate the ‘antipodean impact of the *General Theory*’ on Australian economists and policymakers before 1939. There has been little work, too, on how economists shaped Australian domestic economic policy during the 1930s other than the contributions of Cain and works by Copland (1934), Walker (1933a) and Schedvin (1970). There is little literature examining the deliberations and scope of Australian economic policy from 1936 through to 1939. In that regard, it has been claimed that all Australian economists were basically Keynesian—in theory and policy—by the advent of World War II. Certainly, Richard Downing (1972), a young Australian economist at the time, recalled that this was the case. Given this, it might be said that Australia, bar Sweden, led the way in terms of adopting Keynesianism (Winch 1966). One historian goes so far as to claim that Australian monetary authorities or the central bank practised Keynesian-inspired policy in 1938 to quarantine the nation from the impact of the Roosevelt recession (Gilbert 1973:219). The accepted assessment of Australian economic policy during the

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1930s is, however, usually much bleaker; both the efficacy of economic policy in the 1930s and the theoretical and public contributions of economists were called into question and judged to be comparatively poor against efforts made overseas (Schedvin 1970). This view will be re-examined and found wanting.

In much of the literature for this period there has been little examination of the factors that helped shape Australian public policy, particularly the interplay between economic ideas and economic policy. Peter Hall’s (1989) edited study of the diffusion of Keynesian ideas across nations found that the influence of Keynes’s ideas could not be divorced from particular national circumstances. Hall pioneered three analytical approaches in the study of the way this new economic wisdom percolated down to policy. A ‘state-centred’ approach focuses on the role of policymaking bureaucracies as the creators or, more likely, inhibitors to the diffusion of new economic ideas (Hall 1989:10–12). In this regard, it might be argued that Australia was philosophically attuned in its institutions and prevailing culture for a ready embrace of Keynesianism (Smyth 1994).

Institutionally, Australia had an extensive public sector and publically minded economists, who, up to a point, supported tariff protection and public investment projects on economic development grounds (Whitwell 1986:57). Australia also had a small but active core of university economists all predisposed and well versed in the art of giving practical, level-headed advice to governments (Green 1960:29–32; Cain 1973; Copland 1951). Partly by design and partly by accident, Australia’s central bank financed budgetary deficits using Treasury bills during the Depression and thereby kept the banking system liquid (Copland 1932a). Lastly, Australia possessed a centralised wage-fixing system—‘another form of economic control’—that gave an independent but trusted body, the Arbitration Court, a direct lever over wage levels (Reddaway 1938).

Administratively, therefore, Australia had more than the rudiments of the institutional apparatus necessary for economic management. An embryonic Keynesianism was there but without the philosophical and intellectual conviction among the policy elite.

A second approach of Hall’s is a ‘coalition-centred’ one in which economic policy depends on the interplay between politically mobilised interest groups (1989:12). Here, the emphasis is on politics serving as the clearing house of pressures for different groups with divergent interests (Hall 1989:13). The last approach is the ‘economist-centred approach’. Here, economists and intellectuals play a leading role in not just the dissemination of new economic ideas, but their shaping into policy (Hall 1989:9). As Whitwell (1994:123–4) notes, the

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4 Boris Schedvin’s work Australia and the Great Depression (1970) derives from his Sydney University dissertation, which was entitled ‘Economic policy in depression and recovery in Australia 1927–1935’ (1964). The doctorate, in itself, had some standing being the first PhD awarded by the Faculty of Economics at the University of Sydney (Groenewegen 2009:81). As Schedvin’s study effectively concludes in 1935, it concords with Hancock’s observation that Schedvin pays relatively little attention to the years 1935–39. Dyster and Meredith (1990:146) corroborate this.
The Power of Economic Ideas

economist-centred approach tends to exaggerate the influence economists and new ideas actually have on policy formation. While Hall has argued that for a new paradigm to take hold a nation must have favourable conditions for all three dimensions, we will focus primarily on the latter approach because it draws ‘attention to the qualities of Keynesian ideas themselves. It suggests that these ideas may have a persuasiveness and a political dynamism of their own; and it forces us to ask which ideas make for persuasiveness and which detracts from it’ (Hall 1989:9–10). One must be wary, of course, of taking a ‘delightfully simple’ view of visualising ‘economic theory as the main force behind policy’ (Booth 1983:104). Other factors and variables, besides politics, enter into the process. We adopt this approach, however, because it allows us to focus on how economists underwent a sea change in their thinking and whether that bore any imprint on official economic policy.

The order of this book

This study comprises 10 chapters broken into three thematic parts. The first part, entitled ‘Backing into the limelight: the interwar Australian economics profession’, sets the scene. Chapter 2 reviews the literature on economic ideas and policy together with an early, equivocal assessment of the early Australian economists. Chapter 3 provides some background on the monumental problems confronting the Australian economy in the Great Depression and the economic institutions and conventions policymakers relied on. The last chapter of Part I uncovers the capstone of this study—namely, the Australian economics profession and its theoretical and practical grounding.

Part II, entitled ‘Triumph and tribulation’, recounts how Australian economists seized the opportunity in 1931 to present an economic stabilisation plan adapted and moulded, with some improvisation, from existing economic theory. Chapter 5 discusses the theoretical origins and rationale of the Premiers’ Plan and the measures that preceded it, together with how it was then regarded as a towering achievement for the economics profession. The years that followed, however, were marked by disappointment for the profession with subsequent and quite innovative economic thinking rejected by official authorities. These setbacks to enlightened economic policy form the basis of Chapters 6 and 7. One reason why this professional advice went unheeded was because economic recovery was by then well grounded and the political and monetary authorities were reluctant to do anything to jeopardise it. This could not be said of the bleak years—1932 until 1934—when monetary authorities rejected expansionary economic policy advice prepared by a committee of economists.
The last part of the book, entitled ‘The march of Keynesian ideas’, consists of Chapters 8, 9 and 10, followed by a short conclusion. As monetary reformers, Australian economists had the fortunate opportunity to be able to present their latest views on economic policy—especially the choice between price stability and exchange rate stability—to an official inquiry. This Royal Commission on Banking and Monetary Systems sprang from community dissatisfaction with the conduct of trading banks and the central bank during the Depression. Chapter 8 discusses the commission’s findings—a great part of which was shaped by the evidence submitted by economists. Since some of that evidence cited Keynes’s *General Theory*, its early reception among Australian economists will also be examined. It was a case, as Chapter 9 shows, of the new wisdom finding fertile ground with Australian economists applying this new theoretical insight to dealing, first, with an imbalanced economy, and then with the risk of being affected by an international recession. The first exigency was met by economists recommending a real wage increase while the second was addressed by the central bank taking pre-emptive monetary action to insulate or fireproof the economy from fluctuations in Australia’s trade account. The final chapter briefly discusses how economists played a critical part in shaping Australia’s war finance. Before the advice of economists penetrated into the upper reaches of official policy, the federal government endured a difficult time reconciling greater defence spending with more social spending. Besides dealing with an economic slowdown, it also had to contend with the states reluctant to restrict their borrowings. The judicious advice from economists, together with an enlightened Treasurer, would lighten the government’s woes.