8. The Royal Commission on Monetary and Banking Systems

Introduction

One of the ironies of the 1936–37 Royal Commission on Banking and Monetary Systems was that while the input of professional economists dominated the commission's findings they were barely influential in pushing for the inquiry in the first place. Not perhaps since the 1930 Macmillan Committee on Finance and Industry in Britain had a gallery of economists been afforded a public forum to express their views on economic policy. The evidence given by economists advanced the key issues on which the commission would deliberate. That evidence, among a sea of words, was impressive, representing the state of the art of central banking and also economic theory.[1] Furthermore, it exhibited the latest in contemporary economic wisdom that sprang from Keynes's *General Theory*, which was published just as the commission began sitting. The arrival of that book in Australia is discussed along with an outline of its main theoretical and policy themes.

While the inquiry had been brought to fruition by political pressures on the Lyons government, there was also, as Casey put it, 'the cry of the monetary reformer' shooting through the air (cited in Robinson 1986:79). The prospect of an inquiry into Australia's financial system filled Commonwealth Bank officials with dread. Their apprehension was at odds with what one of the commissioners, Professor R. C. Mills, told a Sydney bank manager—namely, that 'the Commission was superfluous except for giving some people a chance to blow off steam and giving him the opportunity to improve his own education'.[2] Casey was more equivocal, telling a church congregation that the inquiry would be useful even if it only showed how the present system could be improved.[3] Privately, he told Bruce that, while he was initially 'horrified' by the prospect, some good might nevertheless come out of the exercise (Sutherlin 1980:41).

As this chapter will show, Mills's pessimism about the worth of the commission was to be completely dispelled, not just by the evidence given by economists, but by the findings that heralded new milestones in effective monetary

1 '2,400,000 words: banking commission evidence', *SMH*, 5 September 1936.
2 G. Healy to E. Godward, 5 December 1935, Bank of Australasia D/O Correspondence, ANZ Archive.
3 'Banking inquiry; Treasurer's explanation', *SMH*, 21 October 1935.

management. The proceedings, dutifully reported on in the press, were useful in clearing minds on the art of central banking (Giblin 1951). Under examination, therefore, will be the evidence put before the commission by economists. Apart from drawing on hitherto unused archival and newspaper material pertaining to the commission, this chapter will also draw on three relatively neglected studies of the royal commission by Cain (1988b), Booth (1988) and Sutherlin (1980).

For the first time, macroeconomic goals were enunciated in a public forum. The contribution from economists revolved around the priority that should be given to the competing goals of exchange rate stability and economic activity. That debate, apart from causing a minor schism in the economics fraternity, still crystallised the advance made in economic understanding by policymaking authorities. Before examining that debate in some detail, some background on aspects of the commission's raison d'être and membership is in order. There is no doubt that the establishment of the inquiry, taken in the scheme of things, formed part of the push towards greater control and regulation of the economy. The economists had, of course, been predisposed in that direction for some time and this chapter underscores that shift in their economic outlook.

The embrace of planning and control

Among Australian economists there had been a growing reaction against the market as a form of coordination. Two depressions in 40 years meant Australia was 'swept up' in the global tide against capitalism (Schedvin 1995:54). Mauldon (1933) had first raised the issue of 'planning' and an advisory council consisting of experts to help the federal government. As a precursor to the future, the Australian Institute of Political Science in early 1934 conducted a summer school on 'economic planning'. A number of economists, including Walker, Wilson, Giblin, Melville and Shann, contributed papers on the 'blessed' issue of planning (Melville 1934:96). In his address, Walker linked planning with self-sufficiency, arguing that, in Australia's case, self-sufficiency had been pressed on her by the trading policies of other nations (Melville 1934).[4] Wilson gave a more forthright address, arguing 'that the competitive system, neither in its operation nor in its results was justifying the faith of its votaries'. He went on to lament that there were uncoordinated schemes of planning extant but 'with no integrating purpose', so that there was no 'body of principles that could be used as a criterion in perfecting a system of economic planning'. He was pessimistic about whether, in fact, the capitalist order could be preserved (Whitwell 1986:2–5).

4 'Political science summer school', *SMH*, 27 January 1934.

Giblin defined economic planning as 'applying foresight and reason to economic activities', but he agreed with Wilson that, at that time, there was 'no such agreed aim for Australian development'.[5] It was all at this stage still 'an attitude of the mind' (cited in Whitwell 1986:5). In a radio talk aired in 1935, Giblin asked his countrymen to 'experiment boldly' with new models of economic coordination.[6] Like their counterparts in Britain, Australian economists had swung to a marked acceptance of supplementing the market with more 'planning'. As Whitwell (1986:14) amply shows, the Depression brought about an unequivocal shift to the left among local economists insofar as it entailed more regulation and control over economic activity. Brigden conveyed these sentiments in an Australian and New Zealand Association for the Advancement of Science (ANZAAS) Presidential Conference speech given in 1935. He was prepared to recognise that the profit motive was not enough of a guide and rationale for economic life. Instead, he spoke of an economists' utopia where social responsibility and public accountability would prevail among business leaders and bankers (Whitwell 1986:150). Brigden's utopia also encompassed a better technical knowledge of economic management. Like Wilson, he envisaged a central thinking agency that would exhibit technical proficiency and thereby inspire public confidence that events such as the Depression would not reoccur. Finally, he made the very apposite point that catastrophes such as the Depression 'bring about a very radical reform' in, say, central banking or economic management (Whitwell 1986:15). Much later, Kershaw told Giblin the same thing in discussing the speedy evolution of central banking in Australia during the interwar years.[7]

Even before Brigden's landmark speech in 1935, he had enthusiastically given a series of six radio talks on the subject of economic planning in October 1933.[8] To Brigden, planning meant economic stability. As director of the Queensland government's Bureau of Industry, his duties, apart from matters of economic investigation, were to recommend how loan moneys were allocated. It formed part of Premier Forgan Smith's idea of 'orderly planning' (Molesworth 1933:107). The only drawback in Brigden's mind was that he could not always 'speak his mind…on matters of economic policy', lest he become 'an enemy of the people'.[9]

In Western Australia, Shann invited one of his former students, H. C. 'Nugget' Coombs, on to a radio program and asked him to say 'what impresses you most… about our situation'. Coombs bemoaned the penchant for 'palliatives' and the 'evasion of positive action towards recovery'. He felt that Australia had done

5 Ibid.
6 'Shaping the future of Australia', September 1935, Giblin Papers, NLA.
7 R. N. Kershaw to L. F. Giblin, 3 April 1947, RBA, GLG 43-1.
8 Brigden Papers, NLA, Folio 34.
9 J. B. Brigden to F. Mauldon, 26 March 1935, and F. Mauldon to J. B. Brigden, 5 April 1935, UMA FECC, Box 138.

well since 1931 but complacency was now creeping back (Rowse 2002:2). On a higher methodological plane, Melville could see how ignorance, uncertainty and irrationality reduced the neoclassical concept of a self-regulating economist to fiction (Whitwell 1986:8).

The economist who perhaps personalised the shift to planning and intervention was Copland. Radicalised by the events of the 1930s, Copland confessed to a friend that he was impressed with the need for a change in the control of investment and production to endow the economic system with some stability. Even the Lyons government had, against conservative financial opinion, embarked on expanding investment under government control. Copland predicted that there would be a steady movement to the left and he was more than happy to encourage that movement.[10] This allegiance had, of course, already been well noted by colleagues and detractors alike. Many would have felt that surrendering the economic levers to politicians would result in the return of 1920s-style waste. At times, Copland despaired of convincing some of his associates that the political ground had shifted. He told the Canadian economist Harold Innis: 'It's no use arguing with people who have built up dream pictures about the workings of the economic system. They are like young people in love, and it is only the hard fact of the depression that would shake them out of their state of infatuation.'[11]

In September 1936, Copland along with Denis Robertson and Wesley Mitchell was invited to give an address at Harvard University as part of its tercentenary celebrations. Copland's address, which he proudly distributed afterwards, was entitled 'The state and the entrepreneur'. Thematically, it was about injecting greater social control into the economic mechanism and touched on the 'old problem' of the relationship of state control to private enterprise.[12] He told Premier Stevens that his address would find him 'moving still further to the left'.[13]

Copland reported back to his colleagues that all three contributions had independently arrived at the same theme—namely, that 'unfettered enterprise would not produce an economic and social order that would satisfy the aspirations of the common man'.[14] Robertson (1940:118) introduced Copland to the podium saluting him as 'that skilful designer of cunningly mixed cordials for depressed economic systems'. This was high praise from someone whom Copland regarded as one of the 'ablest economists in Britain'.[15]

10 D. B. Copland to Laing, 7 December 1934, UMA FECC, Box 24.
11 D. B. Copland to H. Innis, 4 November 1936, UMA FECC, Box 43.
12 D. B. Copland to F. Alford, 30 March 1936, UMA FECC, Box 41.
13 D. B. Copland to B. S. B. Stevens, 23 July 1936, UMA FECC, Box 47.
14 Harvard Notes 1936, UMA FECC, Box 47.
15 D. B. Copland to B. S. B. Stevens, 16 March 1936, UMA FECC, Box 47.

Copland was delighted with Robertson's comment that there was now general agreement among economists as to the cause of the crisis and even the remedy, though there was still debate as to how far the remedy should be applied (Robertson 1940:126–7). In passing, Copland noted, among his hosts, 'quite a cult' over Swedish economic policy with its 'middle way' between individualist capitalism and extensive state control. That philosophy was, of course, nothing new to Australian economists, though Copland raised no complaint at the neglect of Australia. He did, however, express bemusement at how resistant US economists were to the idea of state control: 'To a visitor from a country which had long ago gone far in this direction the controversies about state control in the US appear a little unreal.'[16]

All Australian economists did not welcome the orientation towards planning and an extensive public sector. The ideologically conservative pair, Shann and Melville, for instance, was loath to be swept along by the collectivist tide. For Shann, the encroachment of government into economic affairs went against his elliptical embrace of neo-liberal political philosophy. It also made for tragedy. Shann's aforementioned discourses into Australian economic history raged against tariff protection and industrial regulation, both of which were perceived as conspiracies against the public (Schedvin and Carr 1995). Yet in 1933, as aforementioned, he had turned to Keynes's popular writings to lament the waste of excess fixed deposits in bank vaults as the economy stagnated. While he was wary of economic interventionism, Shann had some faith in a 'wider planning, a monetary policy that would permit the recovery of equilibrium and an expansion of consumers' demand' (Duncan 1934:167).

Later, with economic recovery in prospect, Shann shifted ground and re-embraced his earlier philosophy. His antipathy to public works and, presumably, the extent of debt to finance them, resurfaced. Melville agreed, consoling Shann with the thought:

> Can we really expect a democracy in a hurry to spend its way out of depression, to exercise any discrimination in the works on which it spends its money? To encourage Governments to spend money on public works is, I think, to encourage them to spend it more or less indiscriminately.[17]

Shann conveyed his complaint of wasteful public expenditure to Davidson, explaining how loan expenditure was futile in 'priming the pump' of private enterprise. It was akin to having money 'poured down a rat-hole'. He believed such borrowing kept up interest rates and gave the economy a distorted or 'false'

16 'Harvard Material', UMA FECC, Box 45.
17 L. G. Melville to E. Shann, 27 November 1934, RBA, GGM-35-2.

structure.[18] In an unsent reply, Davidson defended public works programs, stating that they were remunerative and, in the last resolve, were an 'investment in human welfare'.[19]

As the world retreated into protectionism and regulation, Shann became increasingly pessimistic about the prospects of a return to a market-driven order of liberal internationalism. The truth, too, was that Shann had also become unsettled since he returned to university life. University colleagues in Perth noted his newly found intolerance of criticism (Alexander 1963:156). In the interim, he secured the chair at the University of Adelaide vacated by Melville and left unfilled due to the effect of the Depression on university finances. It was a position that involved a tradition of teaching theoretical economics when he was, first and foremost, an economic historian (Alexander 1963:178). He also did not have a good grasp of economic theory, particularly its mathematical aspect (La Nauze 1939:227). Nonetheless, the prospect of a 'fresh start' at Adelaide excited him.[20] Shann's last letter to Davidson, together with his commentaries for *The Statist* magazine, for which he was the Australian contributor, struck Davidson as an astonishing return to old patterns of thought. He blustered to Hytten that

> [p]oor old Shann has gone over to the sentimental Economists for the present…I am afraid that he is suffering from…an idea that almost every thing in [the] Australian past and present policy is weakened or endangered by wrongful spending, uneconomic propositions etc. I am afraid he, too, has gone up a side street for the present.[21]

Davidson was cruelly accurate. Like others, however, he was shocked when Shann died in rather mysterious circumstances.

Schedvin and Carr (1995:69) speculate that his death, which the coroner found to be suicide, could be attributable to the sea change in political philosophy as the 'pendulum swung to the economics of J. M. Keynes'. The introspective Shann probably felt he was a spent force. Another authority on Shann, Graeme Snooks, also links his death to personal depression brought on by the move to intervention. In short, Shann could not fathom how more regulation could help when too much intervention in markets had caused the problem in the first case (Snooks 1993:28). In contrast, Melville felt there was nothing sinister in Shann's death other than the stress of overwork.[22]

18 E. Shann to A. C. Davidson, 23 April 1935, BNSW, 302/590/1.
19 Draft of A. C. Davidson letter to E. Shann, n.d., BNSW, 303/590/1.
20 E. Shann to J. La Nauze, 12 October 1934, La Nauze Papers, NLA.
21 A. C. Davidson to T. Hytten, 27 May 1935, BNSW, GM/302/386.
22 L. G. Melville to J. La Nauze, 26 July 1935, La Nauze Papers, NLA.

At the memorial service for Shann, G. V. Portus, a professor of Political Science at Adelaide, alluded to the mental torment Shann had been undergoing by remarking how he had begun in the last three months 'to relearn his economics' (Snooks 1993:28). On the day of his death, Shann wrote to Copland regarding commissioning another in the series of anthologies on Australian economic documents. He agreed with Copland's earlier missive that it will 'do me a deal of good to sort out my ideas with you again'.[23] While he was later to pedantically note that Shann was not really an economist, Copland ensured that he was honoured by a memoir of him penned by Melville. Copland was happy with the tribute because it emphasised the 'mutual dependence of each of us on the others who cooperated in influencing economic policy during the depression'.[24]

Shann's demise meant, of course, that his leavening influence would be absent from the forthcoming Royal Commission on Banking. More surprising, however, was the omission of any form of evidence from the loquacious Copland, who had been the first economist to call for an inquiry into the monetary system (Sutherlin 1980:9). Before turning to the giving of evidence by economists, some remarks on the constitution of the commission are in order.

An inquiry into monetary policy

The political origins of why the commission came to be have been exhaustively covered by Sutherlin (1980) and need not unduly concern us here. In her discussion of the genesis of the inquiry, however, Sutherlin made no mention of early Country Party efforts to push for a royal commission into the setting of the exchange rate. That said, the terms of reference and, more especially, the selection of the officials who would sit on the commission are of palpable interest because, ultimately, they would have a bearing on the inquiry's findings. It is, for instance, sometimes assumed that Copland did not appear before the inquiry or submit written evidence because he was disappointed not to be one of the presiding commissioners. This is quite false. Copland did not present any evidence because, as he told Jock Phillips, the secretary to the commission, he was preoccupied being Acting Vice-Chancellor at Melbourne University and, after that, would be abroad visiting Harvard and Cambridge while the commission sat.[25] In any case, Copland had some indirect input into the commission. Melville, for instance, sent him the *Statement* he was to place before the inquiry. Copland would also write articles on the key findings of the commission. Copland told Melville, nonetheless, that it was 'a thousand pities' that university administration prevented him from taking part in the inquiry.

23 E. Shann to D. B. Copland, 21 March 1935, UMA FECC, Box 38.
24 D. B. Copland to L. G. Melville, 5 June 1935, UMA FECC, Box 36.
25 D. B. Copland to J. G. Phillips, 6 April 1936, UMA FECC, Box 48.

He went on to say that 'the enforced absence from controversy would help in a small way to repair my damaged reputation'.[26] By that, Copland presumably meant his poor standing with the authorities over his philosophical views and, perhaps, his association with Stevens. On the key issue of the political interference in banking, Copland considered that it was nonsense to suggest that banking could be quarantined from politics. He told a friend that '[b]anking has far too powerful a social influence to be ignored in politics'.[27] On this issue, Copland would have been heartened by his colleague Gordon Wood's submission, which was dedicated to arguing the case for greater supervision of the financial sector.

After a year or more of backsliding, Lyons announced in October 1935 the terms of reference for the royal commission and the personnel to preside on it.[28] The terms of reference, drawn up by Casey and Treasury Secretary, Harry Sheehan, were suitably broad (Sutherlin 1980:37). They were: 'To inquire into the monetary and banking systems at present in operation in Australia, and to report whether any, and if so what, alterations are desirable in the interests of the people of Australia [as] a whole, and the manner in which any such alterations should be effected.'

Apart from inveterate opposition to the inquiry from elements such as 'The Group', the private banks and even the top echelons within the Commonwealth Bank, delay was also caused by finding suitably qualified commissioners (Sutherlin 1980:20–31). Initially, the federal government was in favour of appointing a foreign-born chairman. Names such as Lord Macmillan, Denis Robertson, Bertil Ohlin and Per Jacobssen were put forward (Sutherlin 1980:32–3). Political and logistical factors swung the choice towards an Australian chairman. Casey was, at one stage, initially inclined to offer the chairmanship to Giblin (Sutherlin 1980:38). Like Copland, however, Giblin had once too often aired his views on monetary reform in public and was, as discussed above, placed on the Commonwealth Bank Board. Eventually, Justice Napier from South Australia was given the job of chairman of the commission. While some of the six commissioners were specialists in some of the fields pertaining to the inquiry it came as some surprise that only one economist was selected. After screening all the likely candidates, Casey chose Mills because he was the only one 'who has not nailed his opinions to the mast in the press, as practically all the others have done' (cited in Sutherlin 1980:41). Apart from being, therefore, a 'safe' choice, Mills was selected because he had some expertise in the field of inquiry, having written textbooks, with Walker, on the monetary system (Groenewegen

26 D. B. Copland to L. G. Melville, 9 March 1936, UMA FECC, Box 46.

27 D. B. Copland to F. S. Alford, 30 March 1936, UMA FECC, Box 41.

28 'Banking royal commission', *SMH*, 4 October 1935.

2003:7). In the academic sphere, Mills had neglected his research to build, as he put it, a 'factory' of overseas-trained economics ability (Randerson 1953:43; Butlin 1953:181).[29]

Mills's position as the sole economist on the commission drew Janes to comment that 'Mills should have our deepest sympathy. It looks as though he will have to do a lot of carrying for the others.'[30] Janes, however, overlooked the fact that one of the commissioners chosen was H. A. Pitt, a Victorian Treasury official who had served on the Copland Committee in 1931. He was also President of the Victorian Branch of the Economic Society. The other commissioners were J. P. Abbott, a pastoralist and federal politician, E. V. Nixon, a Melbourne accountant, and J. B. Chifley, a junior minister in the Scullin government who professed an interest in economics and banking. While Janes' comment was, therefore, unfair, it was prescient in another sense. Mills was to have a considerable influence on the commission, including drafting the final report (Butlin 1953:182; Markwell 1985:39). Later, his fellow commissioners would praise Mills's diplomatic skills in getting six opinionated men to agree on the path to take. It was Mills's intention, however, to bring down a unanimous report even if it needed his active stewardship. Having missed the excitement and ferment of the Premiers' Plan, Mills now had an opportunity to make his mark. When the report was published, Copland congratulated him for his work, stating that 'it will take its place' with other reports in other countries on central banking.[31] S. J. Butlin (1937:40), an economist from Mills's department, said the inquiry was 'worth the money'.

At the start of the inquiry, Mills was charged with drawing up, with Chifley, a detailed questionnaire that all witnesses would have to complete (Sutherlin 1980:49). Framing the questions being addressed to bankers and economists allowed Mills and Chifley to have some bearing on the agenda. Belying the tag that they were both politically 'safe', Chifley and Mills were, along with their assistant, Phillips, an economics graduate from Sydney, quite predisposed, in fact, to strengthening central bank powers in the name of sane economic management (Sutherlin 1980:49). It was a view not initially shared by Napier, Nixon and Abbott. After questioning one witness, Napier commented that, after six months of taking evidence, it was not clear to him what more the government could have done to meet the situation created by the Depression

29 Among the key personnel in the economics department during the mid-1930s and their place of higher study were E. R. Walker (Cambridge), S. J. Butlin (Cambridge), Hermann Black (Harvard) and R. Madgwick (Oxford).

30 C. Janes to D. B. Copland, 9 October 1935, UMA FECC, Box 34.

31 D. B. Copland to R. C. Mills, 24 July 1937, UMA FECC, Box 54.

other than to expand the supply of treasury bills, which was undertaken. That said, Napier was open to hearing whether there were other 'measures that might have been adopted that would have had a more beneficial result'.[32]

Before examining the contributions of economists to the inquiry and how they shaped the final report it will be necessary to gauge the early reception that Keynes's *General Theory* received in Australia. This is necessary since several economists, without any attempt at grandstanding, referred to it or, indeed, based a considerable part of their evidence on this new revolutionary book.

The arrival of the *General Theory* in Australia

Looking back over the post-World War II period, 'Nugget' Coombs (1981) recalled it as a time of being guided by 'the star' of Keynes. It was, however, a more daunting experience in the prewar years. Australian economists, while not totally opposed to Keynes, were hardly swept along by a tide of new economic thinking. The diffusion and assimilation of the new paradigm in economic thought would preoccupy Australian economists up to the outbreak of World War II. Unlike Keynes's *Treatise*, which was introduced into Australia's Federal Parliament with a dramatic flourish by Theodore in 1930, the *General Theory* had a more prosaic entry into Australia.

Keynes's envoy to Australia

A former King's College student now working with the Bank of England, W. B. Reddaway came to Australia in March 1936 with the 'oven-hot' galley proof in his suitcase (Arndt 1976:282).[33] Reddaway had read it on the voyage and, as this chapter will show, played a leading part in disseminating its contents to his hosts, even using the royal commission as a forum. Reddaway had come out to Australia expressly as the first research fellow at the University of Melbourne, a position funded entirely—and somewhat controversially—from Giblin's directorship fees from the Commonwealth Bank Board (Priestley 2002:135). Given the shortage of economists in Australia, the fellowship was designed to invite

32 'Judge's comment: at the inquiry', *SMH*, 18 July 1936, p. 13.

33 Interestingly, Reddaway was not the only Bank of England officer to arrive in Australia at that time. A month before, two officers—Kershaw and Jackson—arrived. It was a prospect that so concerned Reading that he cabled Montagu about the visit with his worry that it might somehow be linked with the royal commission. Montagu cabled back that Kershaw was in Australia primarily to visit his family while Jackson was here to take an appraisal of the Australian economy and also to consider Australia's case for a loan from the Bank of England to strengthen its London funds. Kershaw further mollified Reading by assuring him that if news of the visit caused the Commonwealth Bank any embarrassment Jackson would immediately return to England (C. Reading to Sir M. Norman, 28/2/1936, BE, GI/287). Both officers did meet important personages, including Casey, while here. News of the visit did not leak.

a scholar to come to Melbourne and perhaps shed new light on contemporary economic problems.[34] It would also keep Melbourne abreast of the latest economic debates in Britain and the United States. Keynes had recommended Reddaway as 'the best King's College trained economist in recent years'.[35] While Copland had wanted Austin Robinson as the first research fellow—much to Keynes's consternation—Reddaway would live up to his commendation.[36] H. V. Hodson, editor of the *Roundtable* magazine, briefed La Nauze about the visitor: 'He was Keynes's star pupil…and is strikingly intelligent to talk to. He hasn't, I think, got the rarefied intellectual atmosphere of the set-apart genius of any science but he has common sense and intelligent perception raised to a very high power.'[37]

Copland greeted the young economist with the remark: 'You will not find Australia as interesting as Russia, but I think it has many things to interest anyone who has the blood of the pioneer in them.'[38]

It was to prove a prophetic challenge and one that Reddaway accepted with alacrity.

Indeed, even on landing on Australian shores, Reddaway found himself in the unexpected position of having to recommend a gentle braking of economic activity since Australia's London balances were threatened.[39] In reply, Keynes admitted to being somewhat 'perplexed' by the Australian problem, attributing it to capital flight on the premise that the royal commission might recommend another devaluation.[40]

Reddaway presented his findings and summary of Keynes's work to a Shillings meeting held on 28 April 1936. So momentous was the arrival of Keynes's book that it was agreed that the book be the focus of attention at further meetings. Reddaway's attempt to convey the meaning of the *General Theory* to the gathering, which included Copland and Giblin, was obliquely entitled, 'Is the idea of a fair rate of interest a mere convention?' (Brown 2001:54–5).[41] The review, which reduced Keynes's system down to a system of simultaneous equations, was the progenitor of John Hicks's IS/LM framework of analysis. The savings–investment dichotomy of the *Treatise* was retained but now the difference between the two aggregates determined output, not the price level. The policy import was much

34 'Conditions of the research job', Giblin Papers, NLA.

35 D. B. Copland to Vice-Chancellor R. E. Priestley, 2 December 1935, UMA FECC, Box 37.

36 L. F. Giblin to J. M. Keynes, 17 September 1935, UMA FECC, Box 34; D. B. Copland to J. M. Keynes, 13 September 1935, KPKC, L/35.

37 H. Hodson to J. La Nauze, 16 January 1936, La Nauze Papers, NLA.

38 D. B. Copland to W. B. Reddaway, 1935, UMA FECC, Box 37.

39 W. B. Reddaway to J. M. Keynes, n.d., KPKC, L/36/48.

40 J. M. Keynes to W. B. Reddaway, 11 April 1936, KPKC, L/36/50.

41 'Minutes of the Shillings meeting', 28 April 1936, Giblin Collection, UMA FECC, Box 219.

clearer; with resources unemployed, it was investment that determined savings, not the converse, and more importantly, they equalised not through variations in the price level but by changes in output. Unemployment could be reduced by increasing aggregate demand up to a point when supply constraints came into play.

Cain felt that Reddaway's interpretation of Keynes was excellent and gave a 'flying start' to the technical discussion that followed (Cain 1984:367). The paper was rushed into print and became the first published academic review of the *General Theory* (Reddaway 1995:6). It also met with Keynes's approval even though Reddaway was critical that his mentor oversimplified discussion of several matters. Interestingly for our purposes, Reddaway (1936:35–6) felt that Keynes tended to underplay 'the dangers of expansionism'.

The economists in Sydney were not to be outdone by Melbourne having an 'envoy' from Keynes within their midst (Millmow 2003b). Walker and S. J. Butlin had both undertaken higher studies at Cambridge while Keynes was cogitating on the *General Theory*. Both were supervised by Denis Robertson and were, therefore, more observers than participants in the 'Keynesian ferment of the early 1930s' (Schedvin 1978:243). Butlin (1946:9) in fact attended Keynes's lectures at Mill Lane during 1933 and 1934 when the central themes of the *General Theory* were being laid out. Walker adapted a proto-Keynesian view that deficit budgets and public outlays were quite defensible when private spending was lagging (Whitwell 1986:11; Cain 1984:83).[42] Before Reddaway had delivered his lecture, Walker wrote a lucid precis of Keynes's new book in the *Sydney Morning Herald* on 14 March 1936.[43] Walker used the opportunity to damn the deflationary policies of the Commonwealth Bank selling Treasury bills to the public in a bid to further slacken the pace of economic activity. Walker stated that the central bank's actions were wrong-headed and that the 'right remedy' was, in fact, to lower interest rates to keep the economy at the highest level of activity possible. He followed it up by giving a lecture on the *General Theory* on 9 June to the NSW Branch of the Economic Society.[44] That address would be good preparation for his evidence before the commission, where he outlined the new wisdom.

While the first green shoots of the Keynesian 'revolution' in Australia were appearing, not everyone was swept up by it. It certainly did not conquer Australia with 'a speed and a thoroughness' akin to the 'Spanish Inquisition',

42 'Financial; a sound policy; public works and recovery', *SM*H, 2 February 1935.

43 'Employment; interest and money; Mr Keynes; again', *SM*H, 14 March 1936. Walker's review is surprisingly not listed in a recent anthology of newspaper reviews of Keynes's great work, probably because the Australian press was never surveyed (see Backhouse 1999).

44 There is no material evidence of what Walker said in that address since the archival records of the NSW Branch of the Economic Society appear to have been lost.

as King (1997:298) claims. Copland, for instance, informed Keynes that being Acting Vice-Chancellor left him little time to absorb his new book.[45] Two months later, R. B. Lemmon, a member of the Economic Society, asked Copland when he would outline Keynes's new book. Copland could only reply that he had 'not read more than 150 pages'.[46] It was a marked difference from the past when Copland had been Australia's leading monetary theorist and the first to digest Keynes's latest work.

A 'worried' Copland told Sir Keith Murdoch that university administration was consuming his time, meaning that he had to neglect 'a good deal of economic literature that I ought to be reading. Any reputation I have will quickly dissipate if this goes on for much longer.'[47] As Australia's most prolific economist of the interwar era, Copland must have felt his professional standing among his peers, or at least keeping abreast of new developments in theory, was beginning to suffer. He told an American academic:

> If we could only make a resolution that we would completely abandon the world and its…affairs periodically for a year or two, I believe we would greatly enrich our science. The ideal is to spend some time in dealing with economic policy and handling practical affairs and then to live the life of a recluse so that there is ample time to think it all over. Once the job of thinking has been done, we should then sally forth again and become embroiled to some extent in practical affairs.[48]

This was, of course, precisely what Keynes had done in order to conceptualise and compose his magnum opus.

Hytten recalled that Giblin had 'been bitten' by Keynes's prophecy of the euthanasia of the rentier.[49] Yet for all his proto-Keynesian leanings, Giblin struggled with swallowing whole Keynes's new theoretical schema. One such incidence was on his voyage to England in December 1937, when Giblin still confessed to lingering doubts about the sweep of Keynes's theoretical schema (Downing 1960:45). A sabbatical spent at King's College, Cambridge, researching the latest developments in monetary theory would clear away conceptual doubts. Copland, knowing how Giblin wrote only under pressure, suggested

45 D. B. Copland to J. M. Keynes, 9 March 1936, UMA FECC, Box 44; D. B. Copland to W. S. Robinson, 14 April 1936, UMA FECC, Box 48.

46 D. B. Copland to R. B. Lemmon, 16 May 1936, UMA Economic Society of Australia, Victoria Branch Files, Box 140.

47 D. B. Copland to K. Murdoch, 14 April 1936, UMA FECC, Box 44.

48 D. B. Copland to Prof. Williams, 1 July 1936, UMA FECC, Box 50.

49 Hytten autobiography, UT, p. 87.

to D. H. Robertson that he should encourage Giblin to compose, especially if he saw 'virtue in his ideas' and especially when they might 'stir up the monetary theorists'.[50]

While Copland had to diffidently translate the meaning of Keynes's new theoretical framework to his honours students, in Sydney, Mills 'kept away from Keynes'. According to one of his old students, Noel Butlin, Mills did so because he felt 'it was beyond him' (cited in Snooks 1991:8). All this flies in the face of Mills and Chifley being exposed to the meaning of Keynes's revolution to the extent that the latter, allegedly, became a 'Keynesian-of-the-first-hour' (Crisp 1961:169; Battin 1997:34).

Like other studies looking at the transmission of Keynesian ideas in the interwar era, Markwell (1985:26) observed that in Australia the process generally 'declined with age and increased with the extent and recentness of direct contact with… Cambridge economics'. This rule of thumb could help explain Walker, Copland, Melville and Giblin undergoing a rapid conversion to the economics of Keynes. Yet Melville felt that his two Melbourne colleagues were, even in 1939, 'not altogether convinced' of Keynes's new schema though strongly beholden to his policy prescriptions (Cornish 1993b:18–19). Similar-sounding sentiments about public works and contra-cyclical monetary policy had been 'floating around' for some time before Keynes 'generalised them in his general theory' (Melville 1971:21). For his own part, while he 'accepted Keynes's general conclusions', Melville remained 'very unconvinced by a lot of the theory in his *General Theory* and it didn't seem to me to be very rigorously thought out but I didn't think his conclusions were not generally correct'.[51] Unlike his colleagues Giblin and Copland, Melville later developed some of Keynes's concepts such as expectations, equilibrium shifts and uncertainty.

Closer to the action were two young Australian economists studying in England at the time and each focused on absorbing what Keynes was all about. One was D. H. Merry, a Melbourne economics graduate, working with the Wales, which financed his studies in London. Merry found the *General Theory* a difficult book and recalled one occasion when Keynes came to give a lecture at the London School of Economics: 'I marvelled at how a man that could talk so simply, clearly and correctly would write something like that. I put it down to the fact that he was something of a mathematician.'[52]

The other economist was Jean Polglaze, who was undertaking research at Cambridge on investment spending and business cycles, which was funded by a Rockefeller Scholarship. She told her mentor, Copland, how she attended one of

50 D. B. Copland to D. H. Robertson, 24 December 1937, UMA FECC, Box 55.

51 Melville, TRC 182, NLA, p. 158.

52 Author's interview with Don Merry, 2001.

Keynes's lectures in 1937 entitled 'Footnotes to the General Theory'. She wrote: 'Mr Keynes himself, like the Pyramids, is so exactly what's "expected as to be" almost disappointing, but his lecture was full of interesting stuff and far more intelligible than the General Theory itself.' She noted how Keynes's disciples 'will not allow one sentence of the General Theory to be misapplied'.[53]

'Nugget' Coombs was an even greater puzzle (Rowse 2000). While often regarded as the greatest local convert to Keynesian economics—deeming it the 'most seminal intellectual event of his life'—Coombs' (1981:30) early days of exposure to the *General Theory* were days of frustration. At first, he was not 'impressed' by the new book though he felt Keynes's 'practical implications' were important.[54] Now working under Melville as an assistant economist at the Commonwealth Bank,[55] Coombs had the advantage of a study group with Black, Mills, Madgwick, Walker and Butlin meeting in a Sydney coffee house once a week to discuss Keynes (Cornish 1990:62). This was, of course, the nucleus that had supported the expansionary efforts of Premier Stevens. Despite this arrangement, Coombs could still empathise with La Nauze, who found assimilating Keynes on his own 'a pain-in-the-neck. I am struggling with him, too.'[56]

By September, Coombs was getting to the nub of Keynes: 'I have been trying to make sense out of the theory of the rate of interest. Keynes's work I found unsatisfactory and yet it seems to me to have one aspect of truth and that interest is predominantly a monetary phenomenon.'[57]

The New Zealand-based economist Allan Fisher, who now held Shann's old job at Perth, also confessed to having problems 'digesting' the import of Keynes. Fisher held out hope that Keynes would soon 'provide a text for some general reference upon the conditions for a moving equilibrium'.[58] Fisher later admitted that, like Giblin, he had reservations about accepting the precepts and assumptions underpinning Keynes's theoretical framework.[59]

The import of the *General Theory*

The message implicit within the *General Theory* was that aggregate demand—that is, consumption and investment spending—governed the level of output

53 J. Polglaze to D. B. Copland, 17 February 1937, UMA FECC, Box 130.
54 H. C. Coombs to J. La Nauze, 22 June 1936, La Nauze Papers, NLA.
55 Coombs' thesis had been on a study of public works as a stabilisation policy. On returning to Perth, he rejoined the Education Department. He sought a position with the Wales Bank in 1935 but Shann, acting as his referee, was 'quite abusive' about his former student and thus dissuaded Davidson from recruiting him (Hytten, UT, pp. 127, 172).
56 J. La Nauze to H. C. Coombs, n.d., La Nauze Papers, NLA.
57 H. C. Coombs to J. La Nauze, 9 September 1936, La Nauze Papers, NLA.
58 A. G. B. Fisher to J. La Nauze, 19 November 1936, La Nauze Papers, NLA.
59 A. G. B. Fisher to J. La Nauze, 26 March 1937, La Nauze Papers, NLA.

and economic activity. The level of that expenditure, supplemented by public works, could be either too much or too deficient a level in terms of employing resources. The powerhouse variable of investment spending—determined by the interplay of marginal efficiency of capital and interest rates—was also subject to rank uncertainty. Interest rates were determined by the interaction of liquidity preference and the supply of money. The economy's self-corrective properties were not as effective as classical economists believed: full employment was rarely the natural state for market capitalism. Therefore, aggregate demand had to be manipulated to ensure full employment and price stability. This could be achieved, not by planning or arbitrary controls but by the discrete but subtle use of fiscal and monetary policy by the authorities. These instruments could be used not just to rectify economic disturbances but to maintain equilibrium and economic stability. That said, Keynes had a fairly modest definition of what really constituted full employment. He was equally conservative too about budget deficits, believing budgetary balance should prevail at the end of the business cycle. From his earlier work, Keynes knew all about the perils of inflation just as much as he abhorred the hellfire of dear money. Many of these insights, alas, did not immediately spring out from his book.

The difficulty for policy-focused economists in absorbing the *General Theory* was that, while it was a transcendental work on a new theoretical vision, it was hardly a handbook on counter-cyclical macroeconomic policymaking. Keynes (1937:121–2) reminded his fellow travellers that his suggestions for economies in semi-slump 'are not worked out completely; they are subject to all sorts of special assumptions and are necessarily related to the particular conditions of the time'. Moreover, the *General Theory* was sparing in how to apply this new wisdom to policy. Keynes openly acknowledged this; his book was intended for economists, not mandarins. He admitted '[i]t would need a volume of a different character from this one to indicate even outline the practical measures in which they might gradually be clothed' (Keynes 1936:383). In a letter to Joan Robinson in late 1936, Keynes indicated that he did not want his mind to crystallise on the 'precise lines' of the *General Theory* just yet. He went on:

> There is a considerable difference between more or less formal theory, which my existing book purports to be, and something which is meant to be applied to current events without too much qualification by people who do not fully comprehend the theory. So I am against hurry and in favour of gestation. (Keynes 1982b:185–6)

In another place, Keynes insisted on debate, trusting that 'time, experience and the collaboration of many minds will discover the best way of expressing the ideas' (Keynes 1973:111)—ideas that Keynes held to be 'extremely simple and…obvious' (1936:xxxii). These qualifications did not console Copland, who voiced, with others, his impatience at what Keynes was really saying: 'It is not an easy book…later on, when his ideas are clearer, Keynes may be able to set out the problem in simpler language. This however cannot be done until the theory is more clearly defined.'[60] Keynes himself felt the need for a simpler statement but only after he had absorbed the criticisms of others and had become clearer in his own mind about the sweep of his theoretical system (Keynes 1973:47).[61] His heart attack in 1937 and convalescence prevented this, resulting, as Hyman Minsky (1976:14) noted, in Keynes having 'never fully participated in the hammering out of a polished version of Keynesian doctrine'. There was, then, to be considerable delay in working out the policy implications of Keynes's great book. According to the historian Peter Clarke (1998:50), Keynes was well aware of the process by which his ideas would become more politically telling and 'would undergo a selective process of simplification and distortion'. To have, for instance, his radical ideas on war finance accepted, Keynes wanted them to be 'dressed up' in familiar terms so as not to alienate officialdom (Skidelsky 2000:476). Keynes delivered the modus operandi of the *General Theory* in the pamphlet *How to Pay for the War* (1940),[62] in which the problem, of course, was not an economy in slump but one supply constrained.

Most Australian economists, bar Fisher, would eventually accept Keynes's theoretical framework, but some, such as Melville (1939) and Smithies (1936), put their qualifications and reservations into the public domain. Their respective concerns revolved around the theory of interest rates and expectations, the marginal efficiency of capital construct and, in Smithies' case, the marginal propensity to consume and the alleged futility of money wage cutting. To that end, Smithies, who fancied himself more an economic theorist than Treasury economist, told Copland that after reading Keynes he felt 'there were some pretty serious weaknesses in his argument'.[63] Copland tended to agree, responding that the Australian experience of 1931 showed that, apart from reducing real wages, it was indeed possible to get some benefit from the expedient.[64]

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60 D. B. Copland to Sir W. Leitch, 22 July 1936, UMA FECC, Box 44.

61 A political economist of the highest order, Keynes was always well aware of the practicality of economic ideas, of what was possible and advisable within the prevailing political and administrative system.

62 Earlier, of course, Keynes had, along with many other economists, spoken in favour of counter-cyclical public works to counter the slump. His most famous efforts in that regard were 'Can Lloyd George do it?' (1928) and 'The means to prosperity' (1933). Unlike the classical economists, Keynes's call for these programs had some theoretical underpinnings, sourced from the *Treatise on Money*, prompting him to say in 1929 that 'I know of no British economist of reputation who supports the proposition that schemes of National Development are incapable of curing unemployment' (Keynes 1973:813).

63 A. Smithies to D. B. Copland, 17 April 1936, UMA FECC, Box 48.

64 D. B. Copland to A. Smithies, 23 April 1936, UMA FECC, Box 48.

One step in that journey would be to convince authorities of the need for a sound monetary policy that took macroeconomic balance into account before exchange stability. It is to that we now turn.

The intellectual contribution of economists to the inquiry

The tabling of evidence

> A central bank sets out upon an uncharted sea when it adventures forth to control credit.
>
> — J. B. Brigden, 1936

Acting in their private capacities, 11 economists—Mauldon, Melville, Brigden, Gifford, Fisher, Hytten, Walker, Reddaway, Giblin, Wood and Wilson—presented evidence before the commission. It also included each giving a written statement addressing the issues posed in the questionnaire. Some of these submissions and the discourse through them ran to exorbitant length. Hytten's submission, for instance, meant he was in the witness box for five days.[65] Melville, too, took one day of proceedings just to read his statement.

The remarkable thing about the evidence presented by the economists was that it was, barring idiosyncrasies and nuances, fairly uniform. It was, moreover, more coherent and better informed and thought out than the evidence put forward by the other witnesses, including in particular Commonwealth Bank officials. Giblin (1951:215) found the evidence by Riddle, Bell and Reading to be technically poor, with their answers safe rather than instructive.[66] It was also discordant. Riddle, the first witness to be called before the commission, placed the 'utmost importance' on exchange rate stability.[67] He also stated that, unlike in the immediate past, now the bank had little anxiety over the Treasury bills issue. Sutherlin (1980:96) indicates, however, that the governor was insistent that the bank's primary aim was to prevent fluctuations in the price level. Reading, the chairman of the bank board, was emphatic about exchange rate

65 Hytten appeared in his own right, not representing the Wales Bank. His superior, A. C. Davidson, presented his own submission and testimony. His submission was prepared by the bank's research and intelligence section. Claude Janes had the task of putting the submission together and to the satisfaction of Davidson. He suffered a nervous breakdown from the stress of doing so and was sent off on a tour of Europe to recuperate.

66 The exception here was the submission by A. F. Bell, a member of the bank board who felt the existing powers were inadequate. Bell wanted more banking powers including the liquidity controls mooted by Giblin and Melville ('Central bank: views of the Acting Chairman', *SMH*, 31 July 1936).

67 'Bank Royal Commission Sir Claude Reading gives evidence', *SMH*, 16 January 1936

stability (Sutherlin 1985:118). For Commonwealth Bank officials, preserving the exchange rate was a shibboleth but for others it was a means to a greater end. In this respect, Melville felt the commission's task was to 'select one factor in the economy and attempt to fix it, at the same time endeavouring, as far as possible, to make every other factor in the economy adapt itself to the fixed factor' (cited in Cornish 1999).

Melville saw the exchange rate and the level of foreign reserves underpinning it as fulfilling that role. It was an appropriate marker for a small, open economy dependent on foreign capital. It would serve as a 'compass' by which authorities could steer the economy. This meant pegging the exchange rate and then guiding the economy along that course with appropriate domestic policies (Booth 1988:26). As we shall see, it was the import of Melville's independently crafted and cleverly systematic submission that provoked the most comment from his colleagues (Cornish 1999:122–34; Scott 1992). The economists plumped for achieving economic stability and, to varying degrees, pursuing full employment. Most economists advocated preventing economic fluctuations through counter-cyclical monetary and, in some cases, fiscal policy. To that extent most would have welcomed the report's key finding that '[t]he Commonwealth Bank should make its chief consideration the reduction of fluctuations in general economic activity in Australia, thereby maintaining such stability of internal conditions as is consistent with the change which is necessary if economic progress is to take place'.[68]

That is, the commission decided that exchange rate stability should play second fiddle to overall economic stability. This was the general view of the economists in their evidence to the commission. What, however, was of revolutionary change stemming from the proceedings was that domestic economic activity no longer had to dance to the tune set by the exchange rate. Rather, the exchange rate would be kept stable only as long as domestic economic activity was being maintained. The commission's preference was for the prevention of domestic economic instability and the maintenance of as near as possible full employment (Sutherlin 1980:97). While the commission conceded therefore that 'reducing fluctuations in general economic activity' was not as precise as exchange rate stability, it felt it was a stance of 'fundamentally greater importance'. The same paragraph went on to say that this entailed expanding credit when the economy was in need of stimulus and the reverse when the economy was overheating, with the exchange rate generally kept stable.

68 *Royal Commission to Inquire into the Monetary and Banking System at Present in Operation in Australia, 1937, Report and Minutes of Evidence* (hereafter RCMB), p. 204.

In his evidence, Melville had expressed doubt about whether one could truly use this criterion, rather than the exchange rate, as the compass by which to steer economic policy (Cornish 1999). In fact, Melville was never impressed by the commission's final report, commenting that

> [i]f you went with domestic policies and just let the market decide the exchange rate, you would not get good value. The movements in the rate would be very volatile with no management, and the market would just be motivated by waves of optimism and pessimism…That is not a practicable way of running an economy. (Cited in Booth 1988:38)

Following the approach of Sutherlin (1980), we will delineate the evidence of economists between the objectives of internal economic stability and exchange rate stability.

What the economists were saying

Internal stability

The issue of internal balance came to the fore not just in the evidence of the witnesses but in the commission's final report, which recommended institutional changes to the banking system, either by direct means or by establishing an open market for Treasury bills to manipulate liquidity levels within the economy. In the report, brought down in July 1937, the commission emphasised:

> The general objective of an economic system for Australia should be to achieve the best use of our productive resources…This means the fullest possible employment of people and resources under conditions that will provide the highest standard of living. It means, too, the reduction of fluctuations in the general level of economic activity.[69]

These desiderata required that an intelligently managed central bank, under government direction, had to regulate the volume of credit and currency in the light of the 'general objective of the monetary and banking system'. The exchange rate, together with foreign reserves, had to be brought under the ambit of the central bank (Sutherlin 1980:156–8). By placing the central bank under government supervision—or to be more exact, under the Federal Treasurer's ambit—monetary policy would become better integrated with other arms of economic policy (Butlin 1937:47). Monetary policy was to be made subordinate to the general objectives of the economy. The commission also conceded recourse to public works as an effective remedy for economic depression.

69 Final report of RCMB, 1937

Melville, Giblin, Reddaway and Hytten all reminded the commission that monetary policy had limited effectiveness when taken in isolation from other measures (Sutherlin 1980:160). Among one of the commission's bolder recommendations was that the Commonwealth Bank should have the power to confiscate a percentage of each of the trading banks' deposits that could be varied according to economic conditions. This was advanced because the commission felt that the central bank's power to restrict credit was circumscribed. Both Melville and Giblin proposed this idea to the commission—an idea that was, to be fair, also supported by a member of the bank board, A. F. Bell, in his evidence.[70]

Looking over the conduct of economic policy, the commission was critical of the shibboleth of exchange stability that the Commonwealth Bank Board had upheld since 1931 (Butlin 1937:44). It felt that the internal level of economic activity should take priority. This meant manipulating money supply, or credit, in inverse proportion to the level of economic activity. The Commonwealth Bank, in contrast, by engaging in funding, had inappropriately contracted credit during 1931–34 and failed to take the lead in setting interest rates (Butlin 1937:44).

It was a finding, perhaps, that mirrored what Keynes was saying in the *General Theory*. Apart from the commission's reference to full employment, however, the principal of regulating the level of credit to prevent fluctuations in economic activity was probably of mixed vintage involving elements of old and new economic thought and a fair degree of pragmatism. A royal commission investigating Canada's monetary system in 1933, for instance, had already concluded that management of credit, including the use of liquidity controls imposed on banks, would ensure a more effective economic policy. Most economists agreed that it was the interest rate that was the most important regulator of borrowing. The commission's enlightened approach to economic policy was not just derivative of new economic wisdom but, more importantly, of the hard lessons of policy mismanagement stemming from the early 1930s, including the embarrassment over interest rates between the Commonwealth Bank and the federal government in March 1936. These errors, catalogued by several witnesses, included not devaluing quickly enough, the failure of the Commonwealth Bank to take the lead on interest rates and its relentless pursuit of funding. Apart from allowing the Depression to develop more rapidly than was really necessary, the Commonwealth Bank compounded errors by retarding the recovery process.[71] The consensus from the economists was that the Commonwealth Bank had been too preoccupied with taking precautions to avoid a boom, thereby making the economy more vulnerable to recession.

70 'Central bank: views of acting chairman: powers inadequate', *SMH*, 31 July 1936, p. 12.
71 'Banking: errors of policy: retarded recovery: Dr Walker's views', *SMH*, 25 July 1936, p. 18.

In other words, the bank saw little virtue in expansion, always figuring that it meant increased imports, not increased exports or import substitution (Giblin 1951:217). The Commonwealth Bank's fixation with funding was indicted, with one witness drawing attention to the tangible lack of inflation even with so many Treasury bills extant.

In his damning evidence, Walker exorcised some commonly held falsehoods by demonstrating that the trading banks' credit squeeze of 1931 was the outcome of pressure on the London funds. He was critical, moreover, of the Commonwealth Bank for its failure to act to alleviate the situation by increasing credit at the time.[72] Certainly, some of the economists presented evidence articulating the newly minted wisdom of Keynes. Older economists, such as Giblin and Brigden, did not make direct reference to full employment but rather stressed maintaining a steady level of economic activity.

It was a testing time for some. A few days before he was due to give evidence before the commission, Hytten disarmingly told Giblin:

> The more I think of monetary theories and evidence for our ills the less I see in them. I suppose most parties will regard my conclusions as hopelessly muddled but I can't see any really clear-cut issue. To my mind 'a stable price level' [and] 'a stable exchange rate' are just as much catchcries as 'the single tax' and 'social credit'.[73]

Hytten, however—backed up with technical support from the Wales' economic research department—mounted an articulate, if overlong case for credit management but opposed the idea of liquidity controls.[74] Along with Davidson's submission, Hytten felt the contributions from the Wales were the 'most comprehensive evidence' presented.[75] Hytten enunciated the Keynesian resort of deploying fiscal policy in a slump.[76] His exposition, however, on how that expenditure would fall between output, income, prices and employment displayed some confusion.[77] It was tinged with Hayekian overtones since Hytten believed, like many of his contemporaries, that 'every expansion…carries with it the seeds of another crisis and depression'.[78] Like other economists, Hytten agreed that the main purpose of economic policy, all things considered, should

72 Evidence, RCMB, 1318.
73 T. Hytten to L. F. Giblin, 15 July 1936, Giblin Collection, UMA FECC, 92/141, Box 2 K-T.
74 Evidence, RCMB, 1228.
75 Hytten autobiography, UT, p. 136.
76 'Central bank: currency guardian', *SM*H, 21 July 1936, p. 12.
77 Evidence, RCMB, 1223.
78 Evidence, RCMB.

be to achieve the 'maximum employment of men and natural resources consistent with long term stability'.[79] The exchange rate should be kept stable—not for stability's sake, but to be subservient to domestic economic activity.

Allan Fisher, Hytten's predecessor at the Wales, stressed the more microeconomic role of the central bank—namely, to ensure an efficient distribution of the nation's savings. This, together with avoidance of inflation, would lead to the optimum use of economic resources. Elsewhere Fisher, in passages reminiscent of Shann, argued that the Depression in Australia was the consequence of overexpansion of credit in the wrong areas, especially primary industry.[80] Fisher was sceptical of the use of credit to achieve full employment.[81] With that outlook, it could well be understood why Fisher had differences with Davidson and returned to academe.[82]

Giblin's submission was, like his character, idiosyncratic, ranging over issues such as income distribution, population policy and the need for the Commonwealth Bank to formulate economic policy that would have a bipartisan grounding. Giblin emphasised that discussion of monetary policy was, in a sense, too technical a matter for the commission to handle. It also had to be understood that monetary policy could only ease the pain of any external shocks on the economy and prevent the secondary effects of that first loss in real income.[83] Unlike Copland, Giblin was in favour of an independent central bank. His colleague Wood argued that the chief function of the financial system 'was to keep capital accumulation and purchasing power in balance…and there is justified impatience with a system which fails to assume the power to correlate production, consumption, and saving'.[84]

The submissions by the younger economists, particularly Walker, Reddaway and Gifford, confidently displayed an appreciation of Keynes's new vision. Walker, of all the young Keynesians, was probably the most astute in urging the prevention of the recurrence of deflation, but also inflation, though mitigation of the first should take priority. He also showed the greatest technical command of Keynes's theoretical system by invoking a number of key constructs (Cornish 1990:62). Interestingly, neither he nor Gifford favoured the idea of liquidity controls, believing that the Commonwealth Bank had enough power to manipulate credit efficaciously. Walker favoured the use of monetary and fiscal policy working in tandem, though he felt only the latter would be effective in tackling a slump. Monetary policy would play an accommodating role in easing the financial

79 Evidence, RCMB, 1222.
80 Evidence, RCMB, 1215.
81 'Banking inquiry: evidence in Perth: Prof. Fisher's views', *SMH*, 25 June 1936.
82 C. Janes to D. B. Copland, 15 March 1935, UMA FECC, Box 34.
83 Evidence, RCMB, 1345.
84 Evidence, RCMB, 1235.

constraint. More importantly, it would assist in the mitigation of depressions and 'the stabilization of the purchasing power of money' (cited in Cornish 1990:61). Walker was the consummate Keynesian, emphasising the extreme importance of business confidence when resorting to fiscal policy action. Like Keynes, he felt that only the persuasion of elected officials would lead to better policy and better outcomes. Cooperation between the Commonwealth Bank, the Federal Treasury and the Arbitration Court was ultimately required for economic stability (Cornish 1990:62). Price stability could be addressed partly by enshrining money wage stability with due allowances for skill differentials.[85]

The University of Queensland economist J. K. Gifford burst into the public limelight with an accessible presentation on the meaning of Keynes. Despite his Kiel school background, Gifford confessed to being a devotee of Keynes and 'was very pleased to see the recent development of his theory in his last book'.[86] In his statement, Gifford swept aside the boom–bust trade-cycle views of Hayek and Von Mises and articulated a hydraulic version of Keynes's new schema and policy implications. Consequently, Gifford was bolder than both Walker and Reddaway in taking the line that the central bank should keep the economy in semi-boom without fomenting inflation. He was, in short, an ardent expansionist. He attracted Chifley's attention by advocating massive credit creation to counter a slump (Robinson 1986:133).[87] The year before, Gifford (1935a) had written an article in the *Economic Record* calling for a 'moderate credit expansion to stimulate industry and cause the absorption of the unemployed' even if it meant devaluation.

Reddaway presented an equally synthetic account of the 'new' economics. He rejected price stability as a policy objective because it was the symptom of domestic and international turbulence.[88] Rather, monetary policy should be targeted at maintaining a high level of employment and income. Public works was an effective antidote to a depression while a budgetary surplus was apposite in boom conditions. Reddaway felt that Treasury bills were an unmitigated blessing and did not impede management of the credit base as long as there was an open market for them. Melville had also exaggerated fears of an excessive amount of bills in circulation.[89] An improvement in the London funds would, however, warrant some funding to counter the threat of a boom.[90] Melville's view, in contrast, was that it was hard to build up London funds without some degree of funding beforehand. Reddaway likened it to being fearful that low

85 'Banking control: Dr Walker's views', *SM*H, 23 July 1936.
86 Evidence, RCMB, 1199.
87 Evidence, RCMB, 1197.
88 Evidence, RCMB, 1333.
89 Evidence, RCMB, 1334.
90 Evidence, RCMB, 1335.

interest rates while in the midst of depression might ultimately induce a boom. The two young protagonists came closer on the matter of exchange stability, to which we now turn.

External stability

Melville was insistent that the stability of the exchange rate was not the objective of monetary policy but rather the means to make that policy and its objectives more effective (Cornish 1999). Hytten, to name one, became confused about what really were the ends and means in Melville's scheme. Melville felt that the objective of monetary policy was, like the other economists, to achieve economic stability, price stability and as near full employment as practicable.[91] Melville despaired, however, of conducting an intelligent monetary policy by using a raft of monetary indicators. The conduct of monetary policy would become 'so complex as to be capable of solution only by supermen with absolute power' (cited in Johnston 1993:213).

After reviewing the possibilities, Melville opted for pegging the exchange rate as the datum point for monetary policy. There would be one target and one instrument. Moreover, the target chosen would focus continual attention on the nation's economic bugbear: the external account. This was, of course, the channel through which Australia endured losses and gains in real income from her dealings with other nations. It would be necessary to monitor economic activity to keep the exchange rate steady. The central bank would smooth out any undershooting or overshooting of credit creation by having liquidity controls and an open market for bills. This would ensure 'a sensible sort of discipline' in operating monetary policy. There would still be, however, conflict about achieving the three objectives of full employment, stability in general business activity and a maximum output of production. Indeed Melville suggested that full employment would, more or less, follow as a consequence of achieving the other two objectives. The implication, then, was that pursuing full employment in its own right was likely to jeopardise attaining the other two objectives (Cornish 1999:135).

In his schema, Melville wanted the exchange rate to have an element of 'elasticity' and it was this aspect that separated him from the views of senior bank officials and kept him more within the orbit of the economists (Sutherlin 1980:104–5). Melville's view was that the exchange rate could be changed in exceptional circumstances or cases of fundamental disequilibrium. In that sense his stance was not so removed from the other economists. Reddaway, for instance, sounded almost like Melville in stating that Australia needed an agreed fixed point of

91 Evidence, RCMB, 1116.

reference or a stable exchange rate since it was 'a dependent economy'. That fact alone set limits on furthering Australia's prosperity no matter how adroit monetary policy was.

As an experienced exponent of exchange rate policy, Melville reminded the commission that there was 'no glow of prosperity when the currency is overvalued'.[92] He did not, however, think the rate should vary with seasonal movements in the London funds otherwise the currency would tend to oscillate. Implicit within Melville's analysis, as Cain (1988b:9) points out, was the notion that money wages and domestic prices might have to adjust in times of economic duress to preserve the exchange rate. Melville, however, would not brook deflationary policies just to preserve the exchange rate. He also conceded here that money wage rigidity—one of 'the consequences of Mr Keynes'—might throw a spanner in the works. He also did not envisage in his schema that domestic expansion could ever pose a threat to the stability of the exchange rate; only deep-seated external factors could portend that.

Giblin was struck by the degree of uniformity there was among economists on the exchange rate question. It was really all a matter of degree.[93] That is, there was general agreement among economists that the rate could not be sustained if it was impairing domestic economic stability. For the short run, all of them suggested exchange rate stability and, in the longer run, any conflict between upholding the pegged rate and achieving near full employment should resolve in favour of the latter. Cain (1988b) suggests, however, that for Melville these circumstances would have to be quite special given his general philosophy that ultimately governments could do little about alleviating the economic cycle. It was better, therefore, to make the management of the money supply knave-proof by regulating it through pegged exchange rates than surrender it to government authority. To have his system operate effectively, Melville plumped for liquidity controls on the banks. They were a necessary evil. Melville felt the liquidity controls were 'a cause for worry' as the accounts could interfere and jeopardise private banking operations.[94]

Giblin was one of the few witnesses to bring out the political and partisan aspect of exchange rate setting.[95] His view—shared by other economists—was that exchange rate stability should be welcomed since it would encourage more inflow of private investment (Sutherlin 1980:107). Like the other economists, Giblin eschewed Australia resorting to competitive devaluation because it 'would be fatal to world prospects and in the long run to her own interests'.[96] That said, all

92 RCMB, Evidence, 1143.
93 RCMB, Evidence, 1344.
94 L. G. Melville to A. H. Lewis, 10 August 1937, Melville Papers, NLA.
95 RCMB, Evidence, 1344.
96 RCMB, Evidence, 1344.

the economists praised the 1931 devaluation as a proper, if belated, response to countering Australia's economic difficulties. Reddaway felt that with normalcy returning, devaluation should be used only as an emergency measure.[97] Walker was not so dogmatic, insisting that the trauma of further devaluation was less onerous than the alternative of credit contraction.[98] He was, like Gifford, prepared to swap exchange rate flexibility to gain more employment (Sutherlin 1980:112).

What the other witnesses were saying

Apart from Davidson's lengthy submission, the evidence tendered by the trading banks was predictably antediluvian. Their evidence was focused more on matters of banking and the allocation of capital than on national economic policy (Sutherlin 1980:89). Like all the bankers, Davidson wanted exchange stability but he aligned himself solely with the economists when it came to the debate between internal stability and the exchange rate.[99] His colleagues hardly stirred themselves on that policy dilemma (Sutherlin 1980:114). Reflective of the contretemps of March 1936, Davidson eschewed the notion that the Commonwealth Bank did not have the power to set interest rates. Like other trading bank representatives, Davidson dismissed the notion that banks had deliberately restricted their advances during the Depression except, of course, to speculators or those purchasing luxuries.[100] In fact, Davidson said his bank had directed loans to import-competing and export industries. Darvell, General Manager of the Commercial Bank of Sydney, correctly attributed any decline in loans and advances during the Depression to economic factors.[101] This view was backed up by G. D. Healy of the Bank of Australasia, who denied there was a consensus among the banks to restrict credit during the Depression.[102]

The proposal to establish a compulsory deposit scheme for the trading banks drew the bile of private bankers. Edmund Godward of the Bank of Australasia felt the measure would fit a 'communistic government'. As for its key proponent, Melville, '[h]e is like all the other economists—evolves an ideal and will not see the dangers of his proposals'.[103] Earlier, Healy had noted that allowing the Commonwealth Bank to have more control over banks' credit creation raised the question, '*Quis custodiet custodes?*'[104] Healy told Mills at the hearings that

97 RCMB, Evidence, 1325.

98 RCMB, Evidence, 1298.

99 'Exchange rate: stability needed', *SM*H, 2 June 1936, p. 12.

100 'Banking commission; Mr Davidson's evidence', *SM*H, 9 April 1936, p. 16.

101 'Banking commission; Treasury bills; banker's evidence', *SM*H, 25 March 1936, p. 14.

102 'Trading banks: competition for business', *SM*H, 12 January 1936, p. 10.

103 E. Godward to G. Healy, 25 June 1936, and G. Healy to E. Godward, 21 May 1936, Bank of Australasia, D/O Correspondence, ANZ Archive.

104 Ibid.

the scheme would impinge directly on the private banks' business.[105] The enlightened Davidson agreed, but in his technically sophisticated submission, which ranged over 12 days of testimony, he argued that the art of central banking was better practised by influence rather than by decree (Holder 1970:818).

In his submission, McConnan stated that the private banks had also taken their fair share of sacrifice in the Depression and that they had deferred to the last moment any credit restriction.[106] W. A. Leitch, General Manager of the Union Bank, related the then contemporaneous decline in the trading banks' deposits to excessive government borrowing in the market together with rising import consumption.[107]

Aftermath

Most commentators, including all the economists, held that the commission's hearings and findings contributed to the dissemination and improvement of modern central bank practices. Reviewing the legacy of the royal commission, Melville believed, many years later, that though nothing much was achieved it did get people accustomed to the idea of some regulation of the banking system (Cornish 1993b:16). These powers, alas, due to political and institutional resistance, became operational only with the outbreak of war (Sutherlin 1980). Before that economists remained hopeful that the era of a more effective and coordinated monetary policy was not far off. Certainly, all the reviews of the commission's findings suggested that the age of enlightened central banking had arrived (Sutherlin 1980:178).

In a letter to Mills, Copland was blithely hopeful that, with prosperous economic conditions extant and the trading banks liquid, the Lyons government would quickly implement the commission's findings so as to remove the problem of banking and monetary policy from political controversy.[108] It was, in truth, a vain hope, with another general election about to be fought and the banks already up in arms over the commission's findings.

As Sutherlin's study shows, the Lyons government prevaricated even after the 1937 general election was over—and by that time, the banks' liquidity levels suffered as export prices faltered. This made the prospect of monetary control more untenable. Once again, then, the aspirations of economists in promoting the idea of an enlightened economic policy were nipped in the bud. Massy-Greene informed Copland that Lyons was 'a tired man' and, while eager to adopt

105 'Bank inquiry: lodging of cash minimum', *SMH*, 3 June 1936, p. 12.
106 'Australian banks: full sacrifices in depression', *SMH*, 13 February 1936, p. 12.
107 'Government borrowing bank manager's warning', *SMH*, 20 February 1936, p. 10.
108 D. B. Copland to R. C. Mills, 24 July 1937, UMA FECC, Box 54.

a 'more progressive policy', Page, Menzies and Casey were not of the same ilk.[109] It was Casey, alas, who had the odious task of implementing the commission's findings and winning over the Melbourne trading banks' support. He later told Bruce how he had 'sweated blood' to devise measures that 'will do most good and least harm'. He anticipated, however, that the reforms would be greeted by alarm from bankers who were 'really a most unintelligent crowd'.[110] The technical and political negotiations over, the drafting of the proposed legislation would prove a complicated and protracted exercise (Sutherlin 1980).

The trading banks arrogantly held the view that the Commonwealth Bank Board did not have the professional competence or vision to have greater monetary powers invested within it. In that regard, Davidson issued a Wales Bank circular highly critical of the commission's findings. Interestingly, it was written by a visiting English economist, Noel Hall, along lines suggested by Hytten.[111] It was imbued with Davidson's fears about surrendering monetary policy to the whims of the Treasurer—a figure who showed a penchant for deflationary policy (Holder 1970:826–7). He was joined in this by McConnan, who resented the proposed changes as undue coercion.[112] Both exchanged correspondence on this aspect of control and how they would be at the mercy of the Federal Treasurer. McConnan doubted whether the commissioners could appreciate the 'serious danger' of their recommendation that the Auditor-General be authorised to investigate the affairs of any bank at the whim of the Treasurer.[113] Davidson's and McConnan's dissent also applied to the commission's other key recommendation: that the Commonwealth Bank have greater leverage over the London funds to ensure that Australia's reserves were at the appropriate level.

Copland was annoyed with the mischievous nature of the Wales' *Circular*, believing that its views on banking practice were sound neither in theory nor practice. The *Circular* caused him to 'revise my ideas a good deal about the place of economists in business life'.[114] This was a direct reference to the activities of Hytten and Hall, who provided intellectual support to Davidson in opposing the banking sector reforms. Copland was also incensed at how Hytten was appropriating the title of 'Professor' in his public utterances when he now worked exclusively for the Wales and was, moreover, speaking on matters on which he had apparently little expertise.[115] Behind this pedantry, perhaps, lay Copland's annoyance that the Wales was reducing its support for the Economic Society. That aside, Copland decided to counter the Wales' *Circular* by penning

109 Sir W. Massy-Greene to D. B. Copland, 15 June 1937, UMA FECC, Box 54.
110 R. G. Casey to S. M. Bruce, 3 May 1938, Casey–Bruce Correspondence, AA, A1421 (4).
111 A. C. Davidson to T. Hytten, 14 August 1937, Cablegram, BNSW, GM302/386.
112 'Greater powers for the Commonwealth Bank', *SMH*, 1 September 1936, p. 8.
113 L. J. McConnan to A. C. Davidson, 7 August 1937, National Bank Archive.
114 D. B. Copland to C. Janes, 14 October 1937, UMA FECC, Box 53.
115 D. B. Copland to C. Janes, 2 November 1937, UMA FECC, Box 51.

two favourable articles for the press on the commission's report. He also promised Keynes a brief review of the commission's report for the *Economic Journal*. The resulting article was to the taste of Keynes, who had, incidentally, read the Wales material.[116]

The thrust of these commentaries by Copland, as he told one banker, was to regard the report as forming the basis for building better relations between the banks and the central bank and, more generally, the relations between the banking system and the federal government. It represented an opportunity to institute the safeguards the commission recommended in order to underline the public responsibility of the banking system but to do so in a way inoffensive to the banks.[117] Copland, however, did not think that the commission recommendations on liquidity controls went far enough. As currently proposed, the controls could be sidestepped by the trading banks resorting to keeping part of their mandatory liquid reserves in the form of Treasury bills and London funds (Sutherlin 1980:190).

In his review of the commission's report, Butlin (1937) welcomed the finding about placing the central bank under political control of the incumbent government, as was now the case in New Zealand. This would allow economic policy to be integrated with other arms of policy, not least public expenditure—something that had been sometimes lacking in the past. Butlin (1937:73) mused about how little the idea of bank nationalisation had been considered except for Chifley's three-page addendum to the final report. Chifley wrote the addendum only to give mandatory voice to Labor Party policy, especially its new platform on monetary policy that had been incidentally released as the commission sat (Weller 1975:140–1; Kuhn 1988:62). The objectives set out in the ALP's new monetary policy sounded similar to the commission's goals but there was ominous mention of having a 'national control of [the Commonwealth's] credit resources'. Chifley wrote the addendum without reference to any of the evidence presented before the commission. By the same token, Chifley admitted that none of the evidence he had heard led him to accept the continuation of private banking (Crisp 1961:169).

Butlin also praised the idea of variable minimum liquidity controls believing it would be effective in reining in lending during a boom. Walker and Reddaway, who in their evidence had not supported the idea of liquidity controls, changed their tune on the report's release. Both agreed with Butlin regarding the minimum-deposits option as arming the central bank with the power to check a boom (Sutherlin 1980:181). Only Fisher voiced some apprehension

116 D. B. Copland to J. M. Keynes, 17 December 1937; J. M. Keynes to D. B. Copland, 28 October 1937, UMA FECC, Box 53.

117 D. B. Copland to L. J. McConnan, 14 August 1937, UMA FECC, Box 54.

about the 'radical' and somewhat vague powers the central bank now had to compel trading banks to hold minimum deposits (Sutherlin 1980:182–3). More perhaps was made of it than it really deserved. Mills later pointed out that the power to call up deposits from the banks—the percentage of which had never been stipulated—would be likely to be used only in periods of acute crisis or when trading banks were proving recalcitrant. Even then, the action had to meet with the consent of the Treasurer. Mills reminded his detractors that the whole spirit of the report was to allow the Commonwealth Bank to continue to regulate the monetary system through the exercise of its existing powers and with the cooperation of the trading banks.[118]

The clause that Federal Parliament, and through it the government, be ultimately responsible for monetary policy would arise only if there were irreconcilable differences between the government and the bank. In that event, the government would give an assurance to the bank that it took responsibility for the policy and its implementation. In short, there would be no repeats of March 1936.

The operative question was whether the delay in arming the Commonwealth Bank with the powers recommended to it by the commission would make the passage through future economic seas more difficult.

118 'Finances in emergency', *The Argus*, 17 October 1938.