10. The economics of near-war

Introduction

The last year of peacetime in Australia was marked by difficult economic choices and political turbulence. The necessity to divert resources into defence as the security environment grew darker was jeopardised by the system of political federation and traditional ideas about public finance. By the end of 1939, there came, however, a moment of economic revelation. As Copland (1945:8) styled it: ‘The lesson of the war is unmistakable in its demonstration that, given a clear and generally accepted objective, we can erect an economic structure far superior to that which we knew during the dark days of the thirties.’

True to Keynes’s prophecy, the urgency of mobilising resources for the prosecution of war marked the light of reason for politicians.

This chapter focuses on when and how policymakers assimilated the General Theory’s framework of matching the country’s real resources with claims on them. There were two stages to this process. The first step—the easier one—was an awareness of transferring idle resources into employment allowing defence outlays to take place that were essentially costless. The second, more involved step was a transfer problem. Once full employment was reached, policymakers would have to check civilian consumption to enable output to be transferred to the war effort. Economists played a critical part in both conceptualising and broadcasting the approach to war finance. At the official policy level, there was initially little recognition of expanding economic activity by bringing idle resources into circulation. As we shall see, this conceptual blind spot would ultimately force a policy crisis on the Lyons government. It revolved around the necessity of how quickly, and the means by which, to increase military spending.

With a deteriorating international environment, Australia faced a resource-funding problem in its desire to augment national defence even if it was modest compared with Britain or Germany. Raising taxes, issuing public loans or recourse to credit finance—that is, budget deficits—would disrupt economic activity. Falling export prices further complicated the difficulties. There was also Casey’s prized piece of social legislation—a comprehensive national insurance scheme—to finance. Budgetary balance, of course, gave way to the exigencies of defence. This spelt sacrifices not just to programs but to political reputations.
Ultimately, the blinkered economic outlook led to a political crisis when Menzies resigned ostensibly over the abandonment of the National Insurance Scheme, arguing, as Copland did, that defence and national insurance could both be accommodated. The conventional view was that social welfare and defence were mutually exclusive. Indeed the Commonwealth Bank recycled a version of the UK Treasury’s view—namely, that using resources for defence needs, even amid 10 per cent unemployment, would reduce the amount of consumer goods that could be produced when the economy recovered (Peden 1996).

Consequently, the budget brought down a few days after the outbreak of war adhered to the traditional pattern of fiscal rectitude. The Federal Treasury, like its British counterpart, did not enunciate any new financial doctrine or idea or show the slightest inclination to Keynesian thinking until well into the war years (Spender 1972:42–3). Australia was, in short, ‘singularly innocent of war economics’ (Walker 1947:110). The gaping lack of progress at the surface did, however, belie some institutional change in the backrooms of policy formulation. How Australian public authorities could resist for so long any experimentation in economic policy under circumstances that invited—indeed needed—bold initiatives needs elucidation.

The purpose of this final chapter, therefore, is to show how economists in November 1939 convinced politicians of that crucial point. It was at that juncture that a Keynesian revolution in economic policy ‘arrived’ in this country (Cornish 1993a). It came just as Keynes articulated how to use the conceptual apparatus of the General Theory to fight a war.

Casey and national insurance

It was Casey more than anyone else who got Lyons to commit to a National Insurance Scheme as an election campaign promise (Richards 1975:34). The venture has interest for our study as the scheme had obvious economic ramifications and also because it further revealed the limitations of Casey when he was placed under pressure. More importantly, it demonstrated the intellectual straitjacket Casey and the Treasury were labouring under over economic policy. Copland welcomed the legislation as it sat well with his desire to establish the provision of more social welfare. Casey’s rival, Stevens, had been making noises about the desirability of such a scheme. The rest of the UAP government, including their coalition partners, the Country Party, was lukewarm to the proposal and wary of its cost. Even after the 1937 federal election, Lyons asked Treasury to draft a statement summarising the difficulties with the scheme (Richards 1975:13). The bill was introduced into Parliament in May 1938. The legislation would
provide disablement, sickness and medical benefits, together with the old age and widows’ pensions, based on a contribution scheme involving employees, employers and the government.

Brigden left the Queensland Bureau of Industry to become Chairman of the proposed National Insurance Commission. It was not long before opposition from the doctors and the friendly societies found expression in Parliament through the Country Party. In one debate, Brigden pleaded with the Prime Minister to urgently attend Parliament as Casey had lost control over the House. Lyons refused, telling Brigden: ‘He talked us into this. I could see the difficulties. I never wanted it, and now he can get himself out of it.’ Parliamentary setbacks aside, Casey prepared the legislation and necessary changes to the public service to manage the scheme. After procrastinating over its introduction, Casey nominated 4 September 1939 as the scheme’s first day of operation. Brigden felt the timing ideal, with the economy, buoyed by greater defence spending, likely to be at full employment.

According to W. C. Balmford, the Commonwealth Actuary, Brigden was out of his depth in the position and also had doubts about the scheme. Cabinet ministers, however, regarded Brigden as an ‘unqualified success’ in his new position. No doubt, Brigden was flustered by the fact that after initially educating the electorate on how the scheme would operate, his office later had to sabotage it (Green 1969:114–15). Had Lyons persevered with the scheme, Brigden felt it would have helped postwar economic management by having a huge consolidation of funds to distribute. Greatly disappointed by its demise, Brigden later took up the post of Secretary to the Commonwealth Department of Supply—again serving under Casey (Clark 1950:3).

According to the Clerk of the Parliament, Frank Green (1969:114), Lyons abandoned national insurance because he did not want to antagonise financial circles in Melbourne. Richards (1975:75) rejects this claim, citing Menzies’ support for the scheme even when its creator, Casey, had shelved it in March 1939 for the sake of military preparedness. National security came before social security (Hudson 1986:105). Apart from the ramifications stemming from the Munich crisis, Casey was taken aback at how much the scheme would cost when fully generated. He had already warned in late 1938 how the economy was under strain meeting the huge jump in defence spending. The failure of a public loan to become fully subscribed in February 1939 fed the anxiety that raising resources for defence meant that taxation would have to be considered.

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1 Irvine Douglas [Lyons’ press secretary], TRC 121/31, NLA, p. 46.
2 ‘Notes on Lyons’s Prime Ministership’, Crisp Papers, Mss 5243, NLA.
3 ‘Canberra gossip’, Adelaide Advertiser, 9 July 1938.
4 P. Heydon to P. R. Hart, n.d., Hart Mss 9410, NLA.
5 The Argus, 29 February 1939.
Casey had plainly not assimilated Hankey’s point that when it came to marshalling resources for defence ‘the limiting factor is not money, but the productive capacity of the country’.6 The economists irreverently called the Treasurer’s unyielding fiscal prudence ‘Caseyism’ (Butlin 1958:201). It was, in part, because Casey listened exclusively to his departmental advisers. They could not detect, as the economists could, that the real problem of war finance ‘could only be appreciated by looking behind “the veil of money”’ (Hytten 1940:66). A cursory review of federal budgets Casey had brought down shows only the merest acquaintance with central economic management. His successor, Percy Spender (1972:44), was, as we shall see, cut from different cloth.

While military spending shot up to nearly £30 million—from a figure of £4 million only a few years earlier—the new outlays still amounted to only 5 per cent of gross domestic product (GDP). Casey was concerned that the higher defence spending might, for the first time in seven years, place the budget into deficit. Apart from Brigden, it was Copland, of all the economists, who appeared the most upset at the abandonment of national insurance, arguing that it was hardly incompatible with greater defence spending. At worst, national insurance would add about £3 million annually to existing social security expenditure. Copland argued that national insurance would exert little demand on resources in its first years of operation, making the argument that it would impair the defence effort a spurious one.7 Indeed, by creating a form of savings, the scheme would have facilitated the marshalling of resources for defence purposes. Britain had not suspended its social security scheme because of the exigency of defence spending, which amounted to 12 per cent of total government expenditure.8 For the Lyons government to falter at the first hurdle in implementing this piece of social legislation was discouraging. Copland felt that the needs of defence could easily have been reconciled by diverting resources away from economic development. Social security needs, in any case, still had to be faced. Pension payments, as a newspaper editorial pointed out, already represented more than 25 per cent of the total provision of social security payments.9

The cabinet decision to postpone the scheme precipitated a political crisis for the government (Martin 1993:261–2). Menzies felt that the government reversing measures it had just placed on the statute books cast it in a dim light. It is not known if Copland’s public advocacy for national insurance attracted or perhaps even reinforced Menzies’ action in resigning from cabinet over the issue. Menzies was perhaps merely using it as an excuse to mount a bid for the leadership. Months earlier, Menzies had requested Copland arrange an interview

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7 ‘We can afford both national insurance and defence’, The Herald, 20 March 1939.
8 Ibid.
9 ‘An economist’s defence of national insurance’, Brisbane Telegraph, 6 March 1939.
for him with Keynes at King’s College when he was to visit England on official business in late 1938.10 Copland told Keynes in confidence that he held Menzies in high regard.11 He was not the only one. The press magnate Sir Keith Murdoch withdrew his support from Lyons believing that the country needed a change in leadership to galvanise the defence effort. He told C. L. Baillieu, ‘We should be forming new industry and forcing industrial development to the utmost of its capacity. Lyons sits still.’12

Menzies was, then, the coming man, but as one informed observer noted, finance was not his strong suit (Spender 1972). Hytten recalled Menzies saying ‘‘I don’t understand mathematics’’ and finance was always mathematics to him’.13 Indeed, on becoming Prime Minister, Menzies’ first federal budget sent a completely inappropriate message to Australians about preparing to endure the costs of the war. This was much to the frustration of economists and Spender (1972:50). Fortunately, Menzies soon delegated the duties of treasurer to a more financially acute colleague who took a more imaginative view of war finance. It was a view provided exclusively by economists. Before their vision, however, was allowed to permeate through to higher authority constraints on funding defence spending loomed large.

The burden of defence

The rigours and pressures of how to fund even a modest defence effort drew out markedly different responses from politicians and economists. It was only when the war became more serious that economists persuaded some policymakers—not all—to adopt a physical resources perspective of economic capability.

The views of politicians

The mounting of only a modest defence effort, as we have seen, caused major political ructions at federal and state levels. In the 1938/39 Federal Budget, Casey had ordered a huge increase in defence spending, part of which was financed by new tax imposts. Defence, he insisted, ‘writes its own ticket in matters of finance’.14 Since the enlarged outlays absorbed the accumulated budget surplus, loans were arranged, meaning further Commonwealth borrowing at the expense of the states. When a public loan failed to generate the requisite funds, Casey hoped that his government would realise that defence spending could not be left

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10 D. B. Copland to R. G. Menzies, 29 March 1938, UMA FECC, Box 60.
11 Contained in a note to Keynes in a letter by D. B. Copland to Giblin, 29 March 1938, UMA FECC, Box 220.
12 K. Murdoch to C. L. Baillieu, 4 January 1939, Murdoch Papers, NLA.
13 Hytten, autobiography, 1971, UT, p. 76.
14 Letter to The Argus, 26 October 1938.
strictly to the canons of orthodox finance. The new circumstances—greater defence spending at a time of falling tax revenue—became acute as economic activity slipped due to drought and falling export prices. Economic activity was past its 1937/38 peak. Armed against its critics, the Commonwealth Bank continued to engage in insulating the economy from falling export prices by judicious credit expansion. It served, as we shall see, a dual function.

Greater public works especially by state and semi-governmental authorities, together with the rise of the manufacturing sector, kept unemployment about 10 per cent. The growth in semi-governmental authorities’ borrowing, however, which the ‘prodigal’ states of Queensland and New South Wales had masterminded, impeded the Commonwealth’s bid to access funds for defence. Semi-governmental borrowings, especially by New South Wales, were frustrating the Loan Council in its task of providing funds for government and keeping the money market balanced. Canberra wanted the states to coordinate developmental works to give defence capacity the greatest priority. The funding of defence expenditure resulted in a renewed spat between Casey and Stevens over the conduct of monetary policy, particularly whether state loan expenditure and semi-governmental authority spending should be tapered to the needs for greater Commonwealth spending. Public spending by this stage was dedicated mostly to the pre-depression policy of development rather than employment generation.

Anticipating the economists, Stevens wanted the Loan Council to ‘lay aside its habitual preoccupation’ with each state’s claims and focus on developing a national financial policy agreed on by the Commonwealth Bank. This would put men to work and also allow a greater defence contribution. Stevens did not think that Casey should set ‘arbitrary financial limits’ on the amount of public spending that could be undertaken. For Stevens, the real limits were set by the number of men available and, with a pool of unemployment, that point had not been reached. For his part, Casey believed that Stevens’ proposed ‘policy of inflation’ was disrupting Australia’s defence preparedness.

This dispute between the two figures meant that Australia moved gingerly in its defence preparations. The Munich crisis of September 1938 triggered a greater degree of cooperation. By March 1939, all the state premiers expected some resort to credit expansion to finance the defence spending rather than a resort to taxation. It also sparked rumours that Stevens would soon switch to Federal

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16 ‘Flaws in the machinery of loans’, *The Herald*, 8 June 1939.
17 ‘Loan Council’s tasks’, SMH, 30 March 1939.
Parliament and replace Casey as Treasurer.\(^\text{19}\) Ironically, it was Percy Spender (1972:37), Casey’s ultimate successor as Treasurer, who was being pressured to relinquish his seat in favour of Stevens.

In 1939, both Casey and Stevens were, in the space of a few months, removed from their respective positions. After Menzies became the new Prime Minister in April 1939, he dispatched Casey to the new federal Ministry of Supply. Stevens lost the premiership in August 1939 following doubts raised over his economic stewardship after his promise of a budgetary surplus for New South Wales for 1938/39 lapsed into deficit (McCarthy 1967:91). Following two years of balanced budgets, Stevens had planned for a surplus, regardless of the economic slowdown, to further his credentials for federal politics (McCarthy 1967:262). A year later, a chastened Stevens (1940:77) professed: ‘The question of the balance or unbalance of the budget is, within reasonable limits, irrelevant so long as output and employment are kept at a maximum.’

Before then, Stevens’ stance, as far as federal funding of defence spending was concerned, was inspired by a Keynesian understanding.

The whole issue of war economics rekindled the controversy about the possibilities of central bank credit. National credit adherents invoked Clause 504 in the report of the Royal Commission on Banking and Monetary Systems holding that the release of credits or budget deficits could pay for the war (Spender 1972). The Commonwealth Bank strove to stamp out such sentiments and solicited the help of the Treasury. The new Prime Minister also shunned the suggestion, but economists and the central bank saw a role for moderate credit expansion.

Spender (1972:61–2), the new Assistant Treasurer serving under Menzies, also dismissed the lopsided argument, circulated by Stevens and Forgan Smith, that restricting loans for public works to defray more military spending would automatically create unemployment. His superior, Menzies, alas, was beset by the same blinkers as Lyons. The Commonwealth Treasury advised Menzies that public loans and deficit finance of defence expenditure were likely to cause inflation and falling living standards even with an underemployed economy. Overall it was a muddled picture in need of a clear vision.

The views of the economists

It could be said that given their early appreciation of Keynesian economics, the economists could, quite early on, see the resource potential where politicians and office-holders could not. In 1939, as the shadows of war grew darker,

\(^{19}\) ‘Cabinet may be remodelled’, The Argus, 19 October 1938.
Australia had 10 per cent unemployment. Neither political party, though, had a preconception of how to mobilise these idle resources. It could be achieved by additional expenditure on investment and consumption. Credit expansion would also, up to a point, disarm the dispute between the states and the Commonwealth about having to restrict public works. Giblin and Copland had publicly floated this approach in 1938 but without much impact (Copland 1951:24; Walker 1939a:44–5).

In London, Kershaw was as pessimistic as Australian politicians that the greater defence expenditure would exhaust her London funds. He felt Australia should restrict its public works programs and tighten its banking system.20 He concluded that ‘an economy strained by a fall in export prices and slightly inflated by governmental expenditure, will not have an easy task in meeting the financial demands of the war, even with some recovery in external balances as a result of better export prices and lower imports’.21

The economists, led by Copland, Giblin, Melville and Walker, were clear-headed about the circumstances confronting Australia. Copland was probably the first economist to touch on the matter. In April 1938, he wrote, with a Melbourne commerce student, a briefing on the implications of greater defence spending on the Australian economy.22 At the time, the economy was at full employment and Copland stressed that military spending meant a diversion of resources away from civilian use. This could be achieved by taxation, borrowing or creating credit. Copland stressed that the last option was inflationary and offered much less equity than a considered plan of raising finance by taxation and loans.

In reviewing the 1938/39 Federal Budget, Copland argued that the greater amount of defence expenditure—representing about 3 per cent of national income—meant that the states would have to coordinate plans with the Commonwealth and defer spending on development.23 In a series of newspaper articles published in 1939, Copland outlined the repercussions for the economy of a higher level of military spending and the need for economic reorganisation for defence. He reiterated that preparing for war meant Australia could no longer proceed with its normal economic development. Creating, moreover, a modernised defence capability meant more organisation than was the case in 1914, particularly in developing the industrial ability to wage war. There would also have to be a build-up of vital materials and supplies.24 Copland welcomed, therefore, Menzies’ initiative of creating a new Ministry of Supply. Copland suggested that perhaps half of Australia’s public investment being diverted

21 Ibid.
22 ‘Defence expenditure and the Australian economy’, 28 April 1938, UMA FECC, Box 144.
23 ‘An economist sums up on defence spending plans’, SMH, 5 September 1938.
away from infrastructure towards military ends would not gravely diminish the standard of living. The suspension of Australia’s normal economic progress would, however, be the ‘price’ of national security. Copland told an Economic Society gathering that some degree of credit expansion to finance Australia’s defence effort was feasible. At the same forum, Giblin warned that financing the war effort could not be done by merely ‘soaking the rich’. Rather it would be financed by reducing the standard of living of the population, though he wondered whether that would prove acceptable.

Concerned about the lack of coordination in official circles, a frustrated Copland warned that Australians did not seem to realise the peril they were facing and needed another annexation of territory by Hitler to get ‘reasonable agreement upon the need for the vigorous pursuit of the arts of defence’. He noted how Japan had been on a semi-war footing for some years. There was some cause for optimism. With overseas borrowing out of reach, Australia had to rely on its own capital resources. The Commonwealth Bank was undertaking credit expansion to finance the loan program and maintain liquidity levels. It had taken this action to support the money market because there was a drain on funds due to low export prices and an adverse current account. Copland was concerned, though, whether the central bank had the mastery of control to tailor the credit injection to boost employment and activity without incurring rising cost levels, which would have a detrimental impact on Australia’s external account. Second, Copland was concerned whether the Commonwealth Bank had enough control to ensure that the credit tap would be turned off as full employment was approached. Reading expressed confidence to a West Australian politician that the bank would pass this test. The key question was whether the Commonwealth Bank’s actions were prompted by improvisation and learning from the past or, in fact, marked a new economic doctrine. It was the latter case, with the bank expressly following a Keynesian doctrine laid down by its economic advisors.

Both Copland and Melville were attracted by and responded to articles written by Keynes that appeared in *The Times* in September 1939 on how to raise defence spending without incurring rising interest rates. Both responses demonstrated a significant awareness of Keynesian precepts. Copland warned that Australia could only partially imitate Britain’s cheap money policy as she had more access to funds by simply restricting capital exports. Australia, in

25 ‘An economist sums up on Australia’s defence plans’, SMH, 1 May 1939.
26 ‘Credit expansion’, SMH, 29 April 1939.
27 ‘Australian economic conditions, 1939, report no. 2’, 27 March 1939, UMA FECC, Box 64, p. 2.
29 ‘Defence spending must not be allowed to send up costs’, *The Sydney Telegraph*, 4 July 1939.
30 C. Reading to W. A. Nairn, 13 February 1939, Secretary’s Papers: Finance—Credit Expansion, AA, A11857.
31 ‘Finance for defence: Britain’s broad facilities; action limited in Australia’, SMH, 18 August 1939.
contrast, had to contend with low export prices and being a debtor nation. A
continuance of the central bank’s modestly expansionary policy could, however,
with the requisite degree of investor confidence, initiate and advance the dual
achievement of a rigorous industrial program for defence and full employment.
It was essential, Copland added, that Australian governments agree on the same
economic strategy and that the financing method adopted had the support of
the money market. A well-conceived liberal credit policy meant, therefore,
that the Commonwealth Bank issued securities while export prices remained
subdued and then reversed the process when export prices recovered. Too rapid
a monetary injection, Copland warned, would spill over into imports, provoke
inflation and impair Australia’s external credit.

Melville, the President of the Economic Society, gave a lecture on Keynes’s
articles. Six months earlier he had written, perhaps with Giblin’s help, the
Commonwealth Bank’s definitive brief on the canons of financing defence
spending. There was a twist of irony in Melville’s lecture on Keynes’s views
since he had earlier disparaged notions of the ‘euthanasia of the rentier’.32 Now,
with the exigencies of war, Melville was supportive of the tenor of Keynes’s
suggestions, though he would not approve of his use of authoritarian controls
to prevent British interest rates from rising. He agreed with Keynes that higher
interest rates would choke off private capital formation and be injurious to the
fabric of Australia’s finances. There was, as Keynes suggested, a better method for
finding the resources to wage war while the economy was at full employment—
namely, taxation.33 That expedient would, by suppressing consumption and
relieving the external account, obviate the need for capital, price and investment
controls. The advantages of low interest rates were ‘obvious’ to Melville but
the real question was whether they could remain subdued. Melville concurred
with Keynes that central banking techniques, including the postponement
of funding, would keep rates low as long as taxation was stiffened once full
employment was reached.34

Among the audience were Mills, Madgwick and Janes, who all agreed that at full
employment, taxation should replace borrowing as the most responsible option.
Borrowing at full employment would only reward the rich and impoverish
the poor. Contra Melville, Mills and Madgwick felt more and comprehensive
economic controls were the inevitable price of a war economy.

32 Melville, TRC 182, NLA, p. 160.
33 ‘Mr Keynes’s views on interest rates’, Economic Society of Australia, NSW Branch, Speech given on 22
September 1939, Melville Papers, NLA. Two years earlier, Melville told a meeting of actuaries that long-term
interest rates would rise due to greater defence spending and the occurrence of economic booms (‘Wars and
booms: effect on interest rates’, SMH, 31 August 1937).
34 Ibid., p. 2.
A few months before, both Copland and Wood had complained about the lassitude of the federal government in matching Britain’s war preparations. ‘Australia,’ Copland found, ‘had become the conservative country in economic policy in the world in the last six or seven years…and the last home of an almost undiluted form of capitalism.’ By this Copland meant the reluctance to authorise an extensive array of state controls. He had long wanted the same array of economic controls Germany had used. It would make Australia impregnable from attack but he was pessimistic about it materialising. The growing threat to Australia’s security spelt a grave challenge to the ‘apostles of tradition’ who encompassed the current government and the Treasury.

With the outbreak of war, Copland had his wishes granted. There was, institutionally, a growing resort to direct controls. To forestall interest rate rises, for instance, the government commandeered the states’ borrowing rights in the capital market since competing with these other borrowers, it was feared, might push up interest rates. In line with other developments in public finance, the Commonwealth also moved to gain greater control over the financial system (Ross 1995:98; Butlin 1958:200–1). At the outbreak of war, Copland was asked by Menzies to come to Canberra to become Commonwealth Prices Commissioner and Economic Consultant to the Prime Minister, with a status equal to that of a cabinet minister. The formation of these direct controls hardly corresponded, however, with an embrace of Keynes’s new economics; that would come, appropriately enough, from the advice of an advisory committee of economists.

The Finance and Economics Committee

At the organisational level, Lyons had been astute enough to call again on the economists to help garner the defence effort. The Finance and Economics Committee was formed in late 1938. It was, under Giblin’s leadership, to make an almighty contribution to the war effort. Its primary focus within the first years of operation was to integrate Keynesian ideas with traditional public finance and have it successfully incorporated into official policy. There has been considerable discussion of the role and contribution the Finance and Economics Committee made to Australia’s war effort (Whitwell 1986 Maddock and Penny 1983 Cornish 1993a Walker 1947). The following discussion will attempt to visualise the formation of the Finance and Economics Committee as the mobilisation of economic expertise in the nation’s lead-up to November 1939.

Coombs (1981:6) is adamant that the committee gave ‘economic planning of the war’ a Keynesian pedigree. The committee, chaired by Giblin with Wilson and

35 D. B. Copland to W. Downie Stewart, 17 October 1938, UMA FECC, Box 61.
Melville assisting, and under the ambit of the Federal Treasury, was initially charged with looking at the effect on the economy of a loss of command at sea and subsequent closing of trade routes. Lyons proposed to Giblin that it would be an aspect of national economic planning in a near-war situation.36 The Secretary of the Defence Department, Frank Shedden, told Giblin that the committee would ‘authoritatively review the strong and weak parts [of] our national income under stress, and indicate the direction in which planning could strengthen the weaknesses’.37 The idea for the committee came from Wilson. It was the realisation of his ‘central thinking agency’ that he had spoken of in 1934 (Duncan 1934). Wilson had in mind a ‘small thinking committee to which all sorts of problems could be submitted for general advice’ (Whitwell 1986:2). The committee’s primary task would be to advise the Treasurer and his department. Eventually this would amount to the committee challenging the Treasury’s orthodox canons of war finance. After the outbreak of hostilities, Brigden, Coombs, Mills and Copland were added to the committee.

Copland was initially omitted despite having written a comment on an official memorandum in 1938 arguing that Australia could make itself reasonably independent of overseas supplies in an emergency.38 In that comment, Copland warned that Australia had to prepare for the likelihood of war and a trade blockade within the next three years—not the seven years mooted in an official report.39 Copland stressed that the imperative for the federal government was not development but defence policy. Apart from addressing coastal defence and internal transport needs, Australia had to develop a greater defensive capacity in its economic development. This meant diverting resources into developing ‘unproductive’ and ‘costly’ defence industries and it would inevitably spell some incursions on the standard of living. Copland and Giblin recycled these fears at the ANZAAS meeting in January 1939 (Copland 1951:24).

The committee’s main role was to find the means to wage total war. This had to be achieved without causing undue disturbance to underlying economic arrangements and also had to be done equitably and efficiently (Maddock and Penny 1983:31). Waging a war effectively, Giblin pointed out to MacFarlane, usually meant ensuring that first, the economy was at full employment. Second, there had to be a smooth transfer of resources from civilian to war needs and, lastly, this process had to be undertaken by using financial policies.40

36 J. A. Lyons to L. F. Giblin, 27 December 1938, UMA FECC, Box 216.
37 F. Shedden to L. F. Giblin, 18 January 1939, UMA FECC, Box 218.
38 D. B. Copland to R. G. Menzies, 11 October 1938, and R. G. Menzies to D. B. Copland, 12 October 1938, UMA FECC, Box 60.
39 ‘Comment on memorandum on financial problems of Australian defence and development’, 16 October 1938, UMA FECC, Box 217.
40 L. F. Giblin to S. G. MacFarlane, 21 October 1939, Secretary’s Papers: Finance—Prof. Giblin, AA, A11857.
In that regard, the expanded Finance and Economics Committee would have found the Commonwealth Bank’s brief on defence spending for consideration by the members of the Loan Council more congenial than any views coming from the Treasury. Melville wrote the document in March 1939, with Giblin assisting. It was distributed widely. It was a short review of the principles that should guide the central bank in deciding how much to increase or decrease the money supply in certain hypothetical cases involving the necessity to augment defence spending. The bank took the view that when there was unemployment defence spending would not be at the expense of civilian goods as it would be at full employment. When it came to creating credit or public loans from the central bank, the government could apply this method only when not at full employment. A modest loan by the central bank would go a long way in mopping up unemployed resources, meaning that it would have to be reduced ‘as it does its work’. The bank felt that this method would still have an inflationary bias since idle savings would quickly transform into funds seeking investment as prosperity and, in turn, confidence returned due to the injection of spending. The document stated that the ‘business of the central bank’ was to increase or decrease money supply according to economic activity and the level of employment. Full employment, or the approach of it, was good reason therefore to restrict credit. It pointedly concluded by stating that

> [t]he needs of defence have nothing to do with determining the proper supply of money; if a central bank loan is made for defence at a time when the money supply does not require increasing then the country will pay for it through rising prices and general dislocation more heavily than if the money were raised by taxation.

After being given a copy of the document, Copland told Giblin that apart from a few quibbles, he had few reservations about it.

Menzies’ ‘business as usual budget’, brought down only a few days after the outbreak of war, was very much a Treasury-inspired one, with the modest increase in defence spending sourced from taxation and public loans (Spender 1972:50). In his budget speech, Menzies criticised those who believed that war expenditure could be financed entirely by central bank borrowing or the ‘credit of the community’ (Butlin 1958:197). Giblin was not so dismissive of it, perceiving that the whole matter of war finance was one of physically attracting resources to war ends. One of Casey’s last actions as Treasurer had been to ask Giblin, Wilson and Brigden about their views on using credit expansion to finance defence spending. Giblin took a mechanical view that credit expansion

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41 ‘Commonwealth Bank and finance for defence’, 17 March 1939, UMA FECC, Box 63.
42 Ibid., p. 4.
43 Ibid., p. 6.
44 D. B. Copland to L. F. Giblin, 29 June 1939, UMA FECC, Box 63.
was justifiable when there was unemployment in the economy with the proviso that the credit be withdrawn as the slackness was taken up. Wilson, while generally supportive, worried about the effect on interest rates and also the external account when credit expansion was exercised. Brigden’s (1939) reaction, later encapsulated in a short and querulous article in the *Economic Record*, noted how credit expansion would result in rising wage costs as full employment was approached. The problem was that there was ‘no coordination between wages policy and finance policy’ to prevent wage inflation from occurring. Consequently, Brigden concluded that if credit expansion and thus, full employment, were pursued, there would have to be controls on labour, foreign exchange and investment (Clark 1950:3).

The tendency to overexpansion and therefore the need for controls attracted the attention of MacFarlane (Cornish 2000). His department’s view of credit expansion was that it would bring unmitigated inflation; there was no alternative but to raise funds by the orthodox methods of taxation and public borrowings. It was extraordinary to recall that, just two months later, the Finance and Economics Committee overturned the Treasury line of thinking. It freed the new Treasurer from MacFarlane’s dour, arithmetical approach to fiscal policy (Spender 1972:42–3).

It was Giblin who led the crusade of imparting a Keynesian approach to Australia’s war finance. He had a new and more receptive Federal Treasurer to work with, who acknowledged Giblin’s mental vision (Spender 1972:44). Giblin was, of course, aided by the other economists, including Walker, who had just published a book on the subject. Giblin had read a draft of the book and it would have merely reinforced his disposition for adopting a Keynesian approach to defence spending. Giblin felt highly of Walker’s account while Copland called it ‘a first class piece of work’. In another place, Copland (1939) said the ‘great virtue’ of Walker’s book was that it got ‘behind the veil of money’ and stated the defence problem ‘in real terms’. Melville was of the same persuasion.

In January, Walker (1939a) had presented a paper at the ANZAAS conference arguing that sound finance should give way to unbalanced budgets when conditions warranted it. An expansionist policy involving an unbalanced budget was now an appropriate one for Australia. Walker had more than his work cut out for him in Tasmania, where he was economic advisor to the state government and was dealing with Premier Dwyer-Grey, a Major Douglas adherent. Whitwell (1986:11–13) convincingly argues that it was Walker who provided the intellectual sustenance for the Finance and Economics Committee’s

45 D. B. Copland to T. Hytten, 28 August 1939, UMA FECC, Box 143.
46 L. G. Melville to D. B. Copland, 14 August 1939, UMA FECC, Box 144.
47 E. R. Walker Papers, UT, 21/4.1.
Keynesian approach to war finance. This is probably correct but it must be recalled that Giblin was not long back from Cambridge, where he had been imbibing Keynes’s new economic philosophy. It was Giblin, too, who now held an official position of some real influence and authority.

It was Giblin, then, who encouraged Spender to attempt more with fiscal policy. Giblin demonstrated how Australia, with 10 per cent unemployment, could painlessly increase its defence budget without facing resource pressures. Instead of a heavy-handed resort to economic controls, which would intimidate business, Giblin felt the government should increase expenditure through credit expansion. The elimination of unemployment would remove an embarrassment for the government. Convinced, Spender took up the matter with Menzies, highlighting how the financial costs of the war effort could be lightened by putting the unemployed back into work. While the unemployed had, hitherto, been a state matter, Spender believed the initiative ‘would not only be good politics on our part, but sound economics, if we take the lead in this matter’.

Despite the intrinsic political appeal of this, Menzies, labouring under what Copland (1945:10) called ‘the myth of insufficient finance’, could not fathom how more federal spending could solve two economic problems simultaneously. After consulting with his committee colleagues, Giblin re-emerged with a new memorandum called ‘War finance’. Its precepts were to muster the resources necessary for war, maintain civilian production and consumption and spread the burden fairly over society. The increase in defence spending, mooted for a supplementary budget, would come from central bank credit. Spender took Giblin’s proposal to cabinet on 13 November 1939 and announced, in dramatic words, that ‘[o]ne of the objectives of our present policy is to restore and increase the national income. This will enable us to divert resources to defence without encroaching unnecessarily on existing standards of consumption’. Spender made it clear in a second submission to cabinet how borrowing for defence would be from the central bank thus sparing private enterprise from a greater tax burden. Once capacity and full employment were reached, however, taxation would assume its rightful duty and prevent any inflation. This ‘changeover’ point was projected to occur by May 1940. Cabinet accepted this revolutionary new approach to economic policy thereby giving the Finance and Economics Committee an early triumph (Maddock and Penny 1983:35). Behind the scenes, Giblin assured Spender not to be unnerved by the budget falling into deficit, as the reflationary experiment was unleashed. When the Loan Council met that same month, the states were delighted to hear that their borrowings were not cut (Walker 1947:44).

Spender brought down his supplementary budget on 30 November. This was the moment when a Keynesian revolution in economic policy truly arrived in Australia. An English newspaper hailed Spender’s budget as ‘the answer to an
economist’s prayer’ (cited in Spender 1972:45). At this point, it could fairly be said that Australia led the world in macroeconomic management. In October 1940, almost ten years since giving his first address as the Ritchie Research Professor, Giblin gave an address entitled ‘Australia 1940’ at the Victorian branch of the Economic Society. Giblin posed the question how well Australia had adopted itself to financing the war effort. He mooted that the citizenry would have to forgo more consumption with one fifth of national output designated for war needs.48

Conclusion

Tangeroa, Clear Away the Clouds that Ru May See the Stars

— Polynesian prayer inscribed on a stone memorial to Edward Shann at the University of Western Australia

In giving the Joseph Fisher Lecture, R. G. Menzies (1942) noted that ‘[i]n the economic history of the last fifteen years nothing will be more notable than the rise to influence and authority of the professional economist’.

While there had been some resentment at the rise of the economists, Menzies, quoting Edmund Burke, said that society must adjust to new facts and circumstances. In his lecture, Menzies recounted how the Australian economists, led by L. F. Giblin, allowed Australia to undergo a smooth transition to a war economy by channelling idle resources into war preparations. The economists’ advice was justified by the results. By May 1940, as Giblin had projected, unemployment had been absorbed and Australia reverted to the more traditional ways of financing war expenditure but equipped with a stronger, more robust economy. In his own premiership that followed in 1949, Menzies surrounded himself with economic advisers, some of whom had been involved in the events covered in this monograph.

Today one rarely hears praise for economists but rather mockery or ridicule. Australia is a society, as the Australian historian W. K. Hancock (1930) sagely noted, that upholds a collective disdain for ‘scientific economists’. Today, that disdain for economics continues with students electing to bypass it and electives like economic history, macroeconomics and the history of economic doctrine. Perhaps the Global Financial Crisis of 2007–9 will restore interest and with it a change in the regimen of economics degrees towards more economic history and the history of economic thought.

48 ‘Must divert 20 per cent of our income: Prof. Gibin’s views’ ,The Herald 28/10/1940. W. Prest had addressed the same Victorian branch a few months earlier on ‘The Keynes Plan’ of deferred consumption for financing the war effort.
This book was written partly to counteract the mentality that economic history and macroeconomics does not matter by showing how the members of the interwar generation of Australian economists were pathfinders in devising new forms of macroeconomic management. They swept away the clouds to guide the economy using either the exchange rate or, ultimately, full employment as their compass. Their insights and analysis were informed by the analytical framework provided by Keynes's *General Theory*. Coombs referred to being under the guiding influence of the star of Keynes. For the most part, the economists in this triumph were never given any national acknowledgment, though this is often the lot of the economist. More importantly, Australian economists have not been given much coverage or comprehensively examined in the international literature on the spread of Keynesianism across nations. Yet when it comes to Australia and Keynes there was, and still is, a strong bond that carries through at the academic and advocacy level. This study explores for the first time how Keynesianism came to Australia and how it was expressed in thought, ideas and, ultimately, policy advice. In November 1939, Australian economists persuaded the Federal Treasurer to reject the orthodox Treasury line and adopt a Keynesian approach to war finance. While this action was politically expedient, Keynes knew that this means to influence in shaping world outcomes was better than irrelevance. Politicians such as Spender and Menzies saw the promise and power of economics expertise.

This book sought to make a contribution to the history of economics in Australia by examining the thought and ideas of its leading economists in the decade leading up to 1939. As Part I showed, a young Australian economics profession, formally established in 1925, was thrust into an economically turbulent decade. It was to Australia’s fortune that she could call on this small nucleus of economic expertise when policymakers and politicians remained panic struck. While the economists’ first act of stabilisation policy enshrined in the Premiers’ Plan was deflationary, they began to adjust their settings when the longed-for rise in export prices did not materialise.

Australian economists had a difficult field to hoe. Australian policymakers were, and refused to be, guided by any coherently conceptualised view of the proper relationship between the government and the economy. Most did not assimilate a Keynesian framework of national income, aggregate demand, savings and investment until the war years. Fiscal consolidation, a conservative central bank and a complaisant government allowed a deflationary policy to become entrenched. It largely shut out the expansionary line being taken by economists. It was this propensity to cautious expansionism than set the economists apart from policymakers and office-holders, though their voices were muted somewhat by the economic recovery.
Part III focused on how the Keynesian crusade asserted itself, first at the intellectual level, then at the policy level. Economists had success in convincing monetary authorities to temper the level of economic activity. The acid test was, however, whether the same authorities would expand aggregate demand when circumstances and idle resources warranted it in 1939. This they did.

A few months after the death of Keynes in April 1946, J. C. Habersberger representing the Council of the Victorian Branch of the Economic Society of Australia and New Zealand, wrote to Lady Keynes offering condolences. He told Lady Keynes that the Council had arranged a memorial lecture celebrating the life of her late husband. Habersberger also conveyed the words the President of the Victorian Branch of the Economic Society P.D. Philips had recorded on behalf of the membership. It read

That the Council be directed to forward to Lady Keynes a message of appreciation of the great service performed by the late Lord Keynes in the field of science as a whole, and in particular to the special science of Economics and also for the outstanding contrib. to the welfare of the entire British community which he so magnificently adorned.

Lady Keynes thanked Habersberger and the Council of the Victorian Branch of the Society for their ‘moving resolution’. The Lecture was given by Syd Butlin after Giblin, the Victorian Branch’s first choice, declined perhaps due to ill health.

In the postwar era, the Australian economics establishment for a while exhibited a distinctive Keynesian rubric making it more open to heterodox approaches than their North American counterparts. This heritage stemmed from the Keynesian–Cambridge culture sown in the mid 1930s.

The focus of this research monograph was, then, to thematically undertake an examination of how Australian economists underwent a change in their thinking and ideas about economic thought and economic policy in the 10 years leading up to 1939. As the leading players in this tale, they were well aware of their changing world view. In April 1934, Giblin took stock of his colleagues’ philosophical shift since 1929:

Dyason was the one firm and consistent inflationist. Copland went that way in waves with strong back eddies. I was inclined to sit on the fence, not sure of my ground, and opposed to whatever arguments was [sic] put forward too confidently. Brigden I think was the same, and Hytten.

49 J. C. Habersberger to Lady Keynes, 12/7/1946, Minutes of the Council of the Victorian Branch of the Economic Society of Australia and New Zealand, Economic Society, Papers and Correspondence, UMA.

50 Lady Keynes to J C Habersberger, 31/8/1946, Economic Society, Papers and Correspondence, UMA.
Melville was of course a strong deflationist. Melville gradually and reluctantly has moved a very long way, but with always a hankering backward, which found voice from time to time. Shann, more fitfully, has even moved further the same way, and with his regret.51

It was a strikingly accurate assessment of his colleagues’ state of mind but certainly not of himself. By 1934, Giblin had moved leftwards from a cautious deflationist of 1930 to assume the mantle of being a leading proto-Keynesian voice. Missing from Giblin’s appraisal was, of course, the younger generation of Australian economists who, unlike their predecessors, were professionally trained economists. They undertook their studies when theoretical battles were raging in economics over monetary thought and lecture halls were filled to the rafters.

This book attempted to build on Giblin’s survey by carrying it forward to 1939 when, according to L. G. Melville and Richard Downing, all in the Australian economic fraternity were Keynesian at least in policy outlook. Giblin and Walker were, by 1939, respectively the most persuasive and erudite Keynesians in the land, though Giblin, like his older colleagues, would hate to be typecast.

51 L. F. Giblin to E. R. Walker, 19 April 1934, Giblin Papers, NLA.