CHAPTER 6

MEETING THE COST

THE various preparations for an emergency, in the 'thirties, which have already been discussed found their financial reflection in a modest but steady rise in the level of defence expenditure. In the five years immediately preceding the outbreak of war annual expenditure was:

1934-35 . . .	£5,500,056
1935-36 . . .	7,010,120
1936-37 . . .	8,044,783
1937-38 . . .	9,771,783
1938-39 . . .	14,574,886

This scale of expenditure and its rate of increase appeared at the time a very serious matter. The Treasurer, Mr Casey, introducing the 1938-39 Budget, described the estimated defence expenditure of £16,800,000 as "formidable",[1] while the planned figures were described by one commentator as "staggering".[2] Judged by certain tests the expenditure looked very modest indeed: it was an extremely small proportion of the national income and was far lower than expenditure of European countries. Moreover these expenditures and their increase were planned in a period of substantial unemployment, and might well be regarded as replacing other forms of public expenditure to promote rising employment. Nevertheless it is important to bear in mind that to the men who planned them the expenditures did appear very serious indeed.

Apart from the size of pre-war spending plans the important things for the present purpose were the failure in most years to spend to the full the amount appropriated, and the heavy reliance on loans. Thus in 1937-38 estimated defence expenditure was £11,600,000, but actual expenditure reached only £9,800,000. In the last pre-war year estimates were £16,800,000, expenditure £14,600,000. As will be seen when discussing wartime experience, the gap between estimate and expenditure cannot be taken at face value as a measure of the extent performance was at fault, but it does point to the early manifestation of what was to be one of the serious difficulties of the first two years of war: the slowness and incompleteness with which plans for equipping and supplying the Services could be translated by administrative action into reality.

Reliance on loans was in keeping with traditional Australian policy and in any case, with substantial unemployment, might well have been regarded as proper policy in the circumstances. Of the 1937-38 expenditure it was planned that £2,500,000 should come from loans, and of that for 1938-39 £4,000,000. Even this scale of borrowing for defence was regarded with some misgivings, particularly by the Commonwealth Bank. The Bank felt obliged in 1938 to resist a request to underwrite a public

[1] *Commonwealth Debates,* Vol 157, p. 19.

[2] G. Packer, "A Note on Defence Expenditure", *Economic Record,* Dec 1938.

loan of £10,500,000 (including £4,000,000 for defence), proposing as an alternative £10,000,000. That £500,000 should be treated as a matter for serious argument is a good index of the way the scale of defence finance was viewed. By early 1939 the Bank was expressing increasing concern about the maintenance of the scale of borrowing of State Governments for ordinary works programmes in the face of the rise in Commonwealth defence borrowing, although this issue was not to come to a head until 1940.

THE FIRST WAR BUDGET, SEPTEMBER 1939

In spirit the first war budget is more properly regarded as the last of the pre-war budgets. It was "a budget for preparation and not a budget for conflict",[3] despite its having been prepared in the closing days of peace. The Treasurer said apologetically: "It is true that it was prepared in face of a vast defence expenditure but the fact remains that, having been prepared in a time of peace it is being delivered in a time of war, and that accordingly . . . it must be regarded as having an extremely tentative character."[4] Early revision was foreshadowed.

Perhaps because of its origin, the budget was accompanied by little in the way of statement of principle. The Treasurer spoke of "a just balance between the taxpayer on the one hand and the general credit resources of the country on the other—between the man who will pay currently and the man who will pay in the future".[5] This was no more than a hazy principle of equity and amounted to nothing but a reason for combining taxes and loans. The Treasurer went on to deprecate reliance on "the credit of the community", pointing out that "at whatever earlier point the limit of central bank action may be reached, it is undoubtedly reached when the resources of manpower, material and equipment are as fully engaged as practicable".[6] Except for these comments the budget disclosed no clear financial doctrine, and the comments were addressed to the more unorthodox members of the Opposition, rather than being related to the economic circumstances of the time when full employment was a distant possibility.

Defence (including supply) was estimated to involve £33,137,000 for 1939-40—although the Treasurer added "even before I have spoken the words I know that it has passed the £34,000,000 mark".[7] This it was proposed to finance thus:

Current revenue	£12,012,000
Surplus revenue 1938-39	627,000
Trust funds	1,426,000
Loans	19,072,000

[3] *Commonwealth Debates,* Vol. 161, p. 401, 12 Sep.

[4] *Commonwealth Debates,* Vol. 161, p. 319, 8 Sep.

[5] *Commonwealth Debates,* Vol. 161, p. 323.

[6] *Commonwealth Debates,* Vol. 161, p. 325.

[7] *Commonwealth Debates,* Vol. 161, p. 326.

Other loan expenditure proposed was £2,000,000 for postal works and £2,000,000 for farmers' debt adjustment, making a total loan programme of £23,072,000.

Increases in expenditure from revenue—other than for defence—brought the total budget commitment (excluding loans) to £101,916,000; fore-casted revenue, at existing rates of taxation, came to £96,030,000, leaving a "gap of £5,886,000 to be filled". For this the Government planned tax increases:

Income Tax	£2,360,000
Sales Tax	1,420,000
Customs and Excise . . .	2,130,000
	5,910,000

Personal income taxes were increased by a flat 10 per cent. Company tax was increased by 6d from 1s 1.8d in the £ and by abolishing the tax rebate to "foreign" holding companies drawing dividends in Australia. Sales tax was raised from 5 per cent to 6 per cent, the extensive list of exemptions being left untouched. Customs and excise rates were increased on petrol, on lubricating and fuel oils and on spirits.

These proposals were amended within a few days. Company tax was raised to 2s in the £ (estimated to increase yield by £1,000,000) and a special tax was proposed on the sale of gold. The latter proposal was prompted by the sharp rise in the price of gold. The plan was that 75 per cent of the amount by which the price of gold exceeded £9 Australian a fine ounce should be taken in tax. This at once aroused the hostility of all Western Australian members,[8] while the Labour Opposition, as well as objecting to singling out one form of war profit, deplored the effect on sliding scale wage arrangements which gave miners bonuses for increased gold prices. The tax failed to pass the Senate and was replaced by an excise duty of 50 per cent of the excess price, with an exemption of twenty-five ounces a year for prospectors.

These relatively moderate increases in taxation were the obverse of the large increase in the relative proportion of war expenditure which it was now proposed to finance by way of loans. Whereas in the immediate pre-war years roughly a quarter of defence spending was derived from loans, the proportion in this budget had been increased to more than half. Except in this the budget did not disclose any departure in structure from the other peacetime budgets.

Following the September budget formal provision was made for control of private investment by Capital Issues Regulations,[9] inspired in part by the desire to follow British example and with memories of action along the same lines in the war of 1914-18, and in part by a recognition that in time reliance on loans would involve a serious competition from private

[8] Gold mined at Kalgoorlie and elsewhere in Western Australia represented £10,000,000 of Australia's production of £14,000,000 in 1938.

[9] Statutory Rules 1939, No. 117, 13 Oct.

investment unless interest rates were to be greatly increased, government policy being that they should be held down.

Important discussion, however, centred on another source of probable competition in the loan market, that from State governments and semi-governmental bodies,[1] a discussion complicated by the continuing fear of unemployment. In the Financial and Economic Committee, before the next budget, practically the only discussion of public finance was directed towards the importance of pressing on with defence works in order to absorb the unemployed. The Commonwealth Bank, while it continued to foreshadow the necessity to restrict borrowing for other than defence purposes, gave special temporary assistance to various semi-governmental bodies explicitly for unemployment relief. At the first wartime meeting of the Loan Council in November 1939 there was discussion of the probable need for the States to restrict their loan programmes. But the States were far from responsive and the Commonwealth was particularly vulnerable to the argument that, until defence expenditure increased considerably, any let-up in State activities would merely add to the amount of unemployment. The issue was accordingly not pressed and the report of Mr Menzies' statement to the Council was a fair summary of the attitude of the Commonwealth:

> . . . the borrowing programme with which the Loan Council is confronted, together with that facing the Commonwealth Government in regard to defence and war requirements, represents a formidable task. He indicated that he thought it would be possible to finance ordinary requirements up to 30th June next, but he could see little prospect of a repetition of the same programme next year. He urged the undesirability of a sudden reduction of State programmes next year and suggested the advisability of a gradual tapering off of the State works programmes during the remainder of the financial year to coincide with the gradual increase of defence expenditure.[2]

This attitude was partly tenderness for the States, partly recognition of the existence of an already high level of unemployment and the risk that this would rise before Federal war expenditure increased enough to offset it. Soon after the council meeting, the Commonwealth announced that it would spend, through the agency of the States, £2,000,000 on defence works of low priority to relieve unemployment. The policy was thus explained:[3]

> Some recession in the employment position has been apparent recently and the Government is of the opinion that it is desirable to bridge the gap between the present and the time when the full economic effect of the rapidly-growing defence expenditure will be felt. There is a large number of works which are not of sufficient importance as defence measures to be included in the normal programme of defence expenditure. The sum of £2,000,000 which the Government is making available in order to undertake these works, will be expended upon projects which are of such a nature as to provide for the greatest degree of employment of unskilled labour. It was decided that this amount would be distributed over the various States on a basis which would mainly take into account three factors, namely the degree of

[1] That is, municipal and shire councils and statutory corporations.

[2] Minutes of Loan Council Meeting, 9-10 Nov 1939.

[3] *Commonwealth Debates*, Vol. 162, p. 1268, 17 Nov.

unemployment in the various States, the value of the works for defence purposes, and the population of the States. The Commonwealth officers have been collaborating with the appropriate State authorities with a view to the selection of works which could be carried out under this arrangement, and schedules have now been prepared of works which fulfil the desired purposes. The sum of £2,000,000 will be allocated as follows:—

	£
New South Wales	850,000
Victoria	470,000
Queensland	280,000
South Australia	175,000
Western Australia	125,000
Tasmania	60,000
Amount reserved to meet unforeseen contingencies	40,000
	2,000,000

To some extent the distribution represented an attempt to pacify States in which, of necessity, direct expenditure on the war was and would be low. Important provisions in the New South Wales arrangement were that "the money to be advanced was to be in no way a contribution to the budgetary position of the State; secondly it was in no way to diminish the amount to be expended by the State in the relief of unemployment".[4] It was plausibly alleged, and equally plausibly denied, that the money was in fact used in substitution for State unemployment relief. The circumstances were such that a precise check is impossible, although some measure of such substitution does appear to have occurred; the point is of little importance in itself but does emphasise the prominence which post-depression attitudes to unemployment took in all discussions of early wartime policy.

REVISED BUDGET, NOVEMBER 1939

By the end of November 1939 the Government was able to make a better guess at war expenditure and a revised Budget was presented by Mr Spender[5] as Acting Treasurer. It was the occasion for a clearer and more extended statement of principle, reflecting the degree to which Spender was receptive to the ideas of some of the more academically trained temporary staff recently recruited to the department, and foreshadowing his disposition to seek advice from outside the established Treasury organisation.

It is necessary for us to consider this problem in terms of the resources which will be required both for the war effort and for the civil needs of the people. Only the resources now available can be used for these purposes. To see the problem as one of making the best use of resources makes it clear that the real burden of our war effort must be borne now; that it cannot by ingenious financial devices be shifted to the future. Once we recognise this fact we can concentrate our attention

[4] *Commonwealth Debates*, Vol. 163, p. 235, 19 Apr 1940.

[5] Hon Sir Percy Spender, KBE. MHR 1937-51; Asst Treas 1939, Treas 1940; Min for the Army 1940-41; Min for External Affairs 1949-51; Ambassador to USA since 1951. B. Sydney, 1 Oct 1897.

on securing the necessary diversion of resources from peace to war purposes with a minimum of interference with the standards of consumption we have enjoyed in the past, and on avoiding disturbance to the balance of our economy which would make the subsequent transition from war to peace more difficult.

Briefly stated the financial policy of the government is to finance the war effort by a balanced programme of taxation, borrowing from the public and borrowing from the banking system. This summary, however, does little to illuminate how that policy will be applied at any time. The balance between these three methods of finance must change from time to time and the determining factors will be mainly economic. . . .

There is no reason to believe that this dislocation [impact of war] will be more than temporary. A number of factors are working for improvement. First, the proceeds of the recent sales of export products to the United Kingdom are already coming to hand. Altogether they will amount to more than £100,000,000. Payment will probably be received sooner and will affect the banking system more quickly than normal peacetime sales. There has been, indeed, a general improvement in respect of the balance of payments. Whereas in the last two years our reserves of London funds have been substantially drawn upon, in the current year we may reasonably expect some net increase of those funds, perhaps as much as £15,000,000. This is, however, an optimistic estimate, and may be reduced if difficulties are experienced in shipping exports or if there is a very great reduction of the flow of capital into Australia. A second factor working for improvement is that Commonwealth Bank operations are continuing to give support to the banking system and to maintain economic activity. Thirdly, defence expenditure is having an increasingly stimulating effect on the economy generally. While these factors have not yet been fully reflected in the employment of our resources, their effects will continue to become more evident in the coming months.[6]

Accordingly, financial policy was set out as involving two stages—an immediate programme for financing the war during the period of dislocation, to be followed by a long-term plan relying more heavily on taxation.

Faced with the temporary dislocation in the economic system the government considered that for the time being it must avoid action likely to discourage private activity until our resources are more fully employed and our national income has been raised. Consequently the government has decided that, in distributing the cost of its war programme between taxation, public borrowing and borrowing from the banking system, it will for the time being weight the balance towards borrowing with the assistance of the banking system rather than towards taxation.

In accordance with this decision two private loans have been arranged from the banking system; the first for £10,000,000 for Commonwealth and State works and the second for £2,000,000 for special defence works low in the order of defence priority especially chosen to ease the unemployment position until the effects of defence expenditure become fully apparent.

In view of the increases of taxation imposed in September, aggregating £8,000,000, the uncertainty resulting from the outbreak of war and the recent decline of employment, the government is of the opinion that to increase taxation at the present time would merely delay the recovery of our economy, retard the full utilisation of employable labour, reduce the potential of our national income, and consequently interfere with the full prosecution of our war programme. It has been decided, therefore, not to increase further the burden of taxation for defence purposes in this financial year.

. . . When our resources are as fully employed as is practicable and our "real" national income at its peak, borrowing should not exceed the savings of the people available at any time. Any additional requirements should be drawn from taxation. . . .

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[6] *Commonwealth Debates,* Vol. 162, pp. 1851-2, 30 Nov 1939.

> . . . as the economic recovery which has already begun gets under way, the government will necessarily transfer the emphasis in its financial policy from borrowing from the banking system first to borrowing from the public and secondly, and more particularly, to taxation. These financial measures will be supplemented by the other forms of supervision I have outlined to prevent the waste of resources and to eliminate profiteering.[7]

In form these statements of principle continued to be the basis of the Treasury approach to the financial problem for the whole period of the Menzies Government, and from one point of view the subsequent story of financial policy could be presented as a continuing failure to interpret these principles in the way they had been stated by Spender, and to apply them in practice. There was here seen a relapse from the clear recognition of finance as an instrument for mobilising real resources to the pre-war preoccupation with sums of money as such. The doctrine of conservation of resources in the sense of money was a firmly held part of Treasury theory before the war when, from its frequent appearance in the statements of a former Treasurer, Mr Casey, it was irreverently known to some academic economists as "Caseyism". Throughout 1940 and the first half of 1941 the Government found it increasingly difficult to agree on substantial increases in taxation and was unwilling to follow the Spender doctrine of elimination of borrowing from the banking system. By May 1941 when the reluctance to tax and the conclusion of a formal agreement with the banks for loans by them to the Government were central issues in the attack on the Government's financial policy, very little remained of the substance of the principles of November 1939, although the form of words was still regularly repeated.

In application to the conditions of November 1939 the main effect of the principles was that almost the whole of the large increase in planned war expenditure was to be drawn from loans. The new plan envisaged expenditure of £62,014,000 and proposed that only £1,768,000 of the increase from £33,137,000 should come from current revenue. The loan programme was raised from £19,072,000 to £46,181,000. Except for some minor customs and excise increases (on cinematograph film and locally produced petrol) the revenue increase derived from the post-budget proposals of gold tax and further company tax, and revised estimates of yield.

The first Spender budget was also notable for the announcement of three supplementary lines of financial policy. First was the control of private investment under regulations already issued to provide for the control of private investment "so as to conserve the resources required for our war effort. . . . By this supervision and control it is hoped to direct the savings of the people, first into government loans for war activity, and secondly into the development of enterprises indirectly necessary for war activity". Second was the announcement: "The Government is of the opinion that in the financing of the large war effort a low rate of interest is essential. Thus, to reduce interest rates is a definite objective of the

[7] *Commonwealth Debates,* Vol. 162, pp. 1852 and 1854.

government's financial policy. This objective will be reached, however, as a consequence of our whole financial policy, rather than as the result of action directed solely at interest rates."[8] Nevertheless banks had already been required to seek Treasury approval for increases in rates above the levels of 31st August.[9] Third was the declaration that "an important part of our borrowing plan is the issuing of savings certificates to afford people of small means an opportunity to play their part".[1]

The first steps for a limited control of investment ante-dated the November budget. On 5th October the *Sydney Morning Herald,* in predicting "financial control of all forms of investment in Australia", accurately summarised the Government's approach, and defined the object as being

> to conserve investment funds accumulating in the Commonwealth for war and other national purposes. . . . The decision to control investment has been made after a financial review which has shown that the cost of the war will have to be financed largely from loans. It is intended to borrow in Australia as much as possible of the money required and a policy of low interest rates and short term loans is likely to be adopted.

The *Herald* was astray in speaking of "control of all forms of investment", for what was being discussed was a very limited control in which the central object of attention was capital issues by companies and the more obvious alternative methods of raising long-term capital, an emphasis which explains the use of the expression "capital issues" in the development of this policy. In origin the decision to introduce such control appears to have been the not-very-well-thought-out assumption that since there had been a similar control in 1916 under the *War Precautions Act,* and England had just introduced control similar to the one she had implemented in the earlier war, it was desirable that Australia should again do so. Initially, thinking on the subject does not seem to have gone beyond the idea that the raising of loans and the avoidance of high interest rates would be facilitated by some sort of control.

At the first meeting of the Capital Issues Advisory Board,[2] the acting Treasurer could give the board only so general an outline of its functions that it could make very little of them. The most vivid impression which it got was of the accompanying warnings not to act in such a way as to disturb the States, and to remember constantly the problem of unemployment.[3]

Apart from these all that the board had before it were the regulations which had been drafted very largely under the inspiration of the 1916

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[8] *Commonwealth Debates,* Vol. 162, p. 1853.

[9] National Security (Capital Issues) Regulations, Statutory Rules 1939, No. 149, 14 Nov.

[1] At the Loan Council meeting of 19 Jan 1940 the intention to issue was reported to the Council, but since raising of loans solely for defence purposes did not come within the scope of the Financial Agreement the matter did not need Loan Council approval, and was mentioned merely for the information of members. Issue of certificates, in denominations of £1, £5, £10 and £50 (a limit of £250 to any one holder) began in March 1940. The certificates, purchased at 16s for every £, achieved face value in seven years.

[2] It took some time for this title to become settled. It was described by the Financial and Economic Committee as late as December as the Investment Advisory Board, while Menzies in giving Parliament the explanation of its role called it the Capital Issues Advisory Committee. The title Board will be used here throughout to stress the contrast with the Capital Issues Advisory *Committee,* of a very different composition, with which the Curtin Government replaced it.

[3] Extract from Minutes, 30 Oct 1939.

regulations.[4] These provided that a company (which included profit-making society, club or association) should not, without the consent of the Treasurer, be established, increase the nominal capital of the company, or make an issue of authorised capital, or make a call on shares. Nor could any corporate or other body, excepting partnerships, issue securities or give mortgages without consent, with the very important qualification that banks were permitted without restriction to continue normal overdraft finance of business activities.

Beyond this the regulations did not go and it was very soon clear that they suffered from drafting difficulties as well as a lack of clear thought on the object to be attained. The acting Treasurer had announced the regulations with a statement that:

> . . . the main object of the regulations was to conserve the financial and physical resources of the Australian economic system in a period during which there might be unprecedented demands on them for war purposes. The regulations formed one step in a series of measures for coordinating private and public demands on the investment market and on the physical resources of the Australian economy. During a time of war the demands of the government for defence purposes must be paramount and it was the duty of the Government to ensure that the resources of the Commonwealth were utilised in a way which would contribute to Australia's war effort in the maximum possible degree . . . not the intention of the Government to use its powers under the regulations to prevent legitimate industrial expansion in directions which were obviously necessary to keep the Australian economic machinery functioning efficiently during wartime. The government was not prepared, however, to allow unregulated issue of capital for investment fields which were relatively unimportant or for investment which might make undue calls on certain types of resources which were in short supply and which were more urgently needed for purposes closely related to the war effort.

If this is taken at face value the regulations were clearly only an imperfect beginning, and the truth seems to be that thinking had not gone beyond this general conception of limiting competition in the loan market.

There was immediate complaint from the trading banks concerning the provision about overdraft finance. Their reasonable objection was that the regulations required them to be satisfied that the overdraft was being used for expenditure which was normally financed out of current revenue and which would in the normal course soon be recouped, whereas they had no way of telling for what purpose a cheque drawn against an overdraft limit was designed. There was also a good deal of public complaint at what appeared to be, even in that unsatisfactory form, too much freedom for the banks, some of whom were seeking increase in interest rates. The banks were prepared to agree that they would not increase interest rates if they could be freed of the impossible obligations to identify the purpose to which overdrafts were put, and, as the holding down of rates, rather than restriction of lending, was regarded as the end to be achieved, this was accepted. However it was decided that to forestall adverse criticism a definite restriction should be incorporated in the new regulations.

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[4] Statutory Rules 1939, No. 117, 13 Oct. The personnel of the board at its inception was: Sir Claude Reading (chairman), Sir Walter Massy-Greene, J. B. Chifley, C. A. Norris, A. C. Lewis, J. M. Hardie, James McCann.

Another serious defect was that the regulations as formulated would apply to any capital issue however small. If insisted upon, this would have meant an intolerable burden of work as well as an unnecessary restriction. Another thorny subject was borrowing by local government bodies and statutory corporations. At the Loan Council meeting on 9th November 1939 the Commonwealth agreed to exempt from control loans to a total of £25,000 to any such body in any one year, and similarly exempt loans made by State governments to local authorities, although the Loan Council was to be kept informed of all such loans. For loans exceeding £25,000 applications were to be sent to the Commonwealth by the State Premier, with whom the Treasurer was to consult before decision was taken.

The upshot of the quick emergence of these difficulties was that, after only a month, the original regulations were replaced by a completely new set.[5] These provided that the control of new capital raising would apply only to sums exceeding £2,500, or, for mortgages, £5,000. The agreement with the States concerning the method of dealing with State and local authority borrowings was incorporated in the regulations. The other important change concerned the banks. They were no longer required to scrutinise the purpose to which customers put advances, but the interest which they might charge was restricted to the rates operative on 31st August 1939.[6]

The status of the board was advisory. Applications were made in the first instance to the Treasury, which decided all minor cases which did not involve questions of policy. Policy issues and applications involving large sums were referred to the board, which relied for detailed investigation upon two sub-committees with headquarters in Melbourne and Sydney, that in Melbourne dealing with applications from Victoria, Tasmania, South Australia and Western Australia, and that in Sydney with applications from New South Wales and Queensland. These sub-committees were simply appropriate members of the board sitting in each of the two larger cities and consequentially where the decision was not controversial a verdict by a sub-committee was, for practical purposes, a verdict of the board. All decisions of the board were technically recommendations to the Treasurer and were reviewed by the Treasury and, in special cases, were sometimes reversed.

For the job that it was intended to do the board was an impressive and well-equipped one with wide connections in industry and finance. These connections were frequently complained of by the Labour Opposition, whose conception of the board's task was very different from that which, in fact, the board had been given. Considering that task, it is to the credit of the board that there was never any serious suggestion of bias, let alone corruption, in its handling of applications, many of which would have come from persons and businesses with whom members of

[5] Statutory Rules 1939, No. 149, 14 Nov.

[6] Amending regulations a few days later (Statutory Rules 1939, No. 162, 30 Nov) modified this slightly to provide that new advances should be limited to the August rates or $4\frac{3}{4}$ per cent whichever was higher.

the board would have some associations. The operations of the sub-committees and of the full board were coordinated with Treasury policy more or less automatically by the fact that the secretary of the board was the Commonwealth Actuary, Mr Balmford.[7]

In these early months the impact of control of investment was mild and the resulting restriction of business activity not great. The central objective was still seen fairly consistently as that of controlling the rate of interest; in general, control of borrowing and investment was regarded as primarily an indirect means to that end. A meeting of the board in January 1940 agreed:

> That the control under the regulations should be tightened up and that proposals which do not contribute directly to the economic stabilisation of the country or cover expansion in essential industry and those which will not promote employment or assist the exchange position should only be approached with caution. Those of a purely speculative nature should be declined unless their objects contribute to the national interest and in addition there is definite technical evidence as to their ultimate success. Proposals to start or extend retail businesses, chain stores, hire purchase finance and amusement companies should receive little or no encouragement at the present time in the absence of the existence of special circumstances.

The board, when considering applications for the establishment or extension of businesses, apparently did assess "essentiality" of the proposed development along these lines, but the dominant theme was still not the technical nature of the production involved but the directing of streams of money into government loans; the reference to tightening of the regulations related to the board's desire to close loopholes in the system of control, primarily with regard to their effect on rates of interest.

The Treasury even more than the board was at this stage reluctant to become involved in direct control of rates of interest, preferring wherever practicable to achieve this result by indirect means. The limitation on bank interest had been imposed only because of the acute sensitiveness of the Treasury to that criticism of anything which looked like privilege or favour to the banks which is endemic in Australian political discussion, but it soon became clear that it was not practicable to stop at this point. It is normal business procedure in many types of enterprise to accept deposits, and in Australia these were particularly large and well established in the case of pastoral companies whose acceptance of deposits had a history of more than a century. Under conditions promoting an increase in interest rates, the pegging of those on bank deposits and the subjecting of more common forms of capital-raising to control inevitably stimulated businesses which normally accepted deposits to seek an increase in them, and stimulated other businesses to explore the field and offer the inducement of higher rates than the banks were permitted. It hardly needed a reasonable protest from the banks for the board and the Treasury to explore methods of control, for this development defeated the regulations

[7] W. C. Balmford. (Artists Rifles 1916, RAF 1917-19.) Commonwealth Actuary since 1938; Secty Cap Issues Advisory Bd 1939-41; Mbr Cap Issues Advisory Ctee 1941-50; Chmn Cap Issues Bd 1951-53; Mbr C'wealth Marine War Risks Ins Bd 1941-46; Insurance Commr since 1946. B. Warrington, Eng, 28 Aug 1896.

as they applied to banks. The board proposed to solve the problem by a direct prohibition on the taking of deposits, except by banks, at more than 1½ per cent, unless Treasury consent were obtained. This would have been ¼ per cent below the bank rate for a three months deposit and should therefore have meant the diverting back of deposits to the banks. Precisely because of this clear-cut discrimination the Treasury was reluctant to adopt the proposal and would have preferred requiring the receipt of deposits in excess of £5,000 in any year to be dependent upon approval. In the end, however, the Treasury capitulated and interest restrictions were incorporated in amending regulations on 29th March.[8]

These distinguished between building societies and banks on the one hand and other business borrowers on the other. The latter—other than individuals[9]—might not raise new unsecured loans at a rate exceeding 1½ per cent nor pay interest on old loans at a rate higher than that previously paid, or 1½ per cent, whichever was the higher. Building societies required rather different treatment, partly because of their normal reliance upon unsecured loans, partly because of political considerations. In their case the limitation referred to loans fixed for less than three months, for which the limit was 1½ per cent, and loans for longer periods, for which they were permitted a margin rising from ½ to 1 per cent above the Commonwealth Bank fixed deposit rates. The Treasury might consent to a higher rate of interest in all these cases, which meant that in particular those businesses which had normally financed themselves by taking deposits would not necessarily be handicapped.

This was the leading instance in which, at this stage, action was directly aimed at interest rates. The problem of direct evasion of the regulations' purpose was clear-cut and admitted no other solution. But other cases of competition in interest rates were not so easily dealt with; State Superannuation Funds were, under the agreement with the States, outside the regulations, and instances occurred where borrowers rejected by the Treasury found their funds from this source. Since the financial structure and pensions commitments of the Superannuation Funds were directly dependent upon interest earnings it was not possible to do more than seek to persuade the States to refrain from such direct competition.

The other important change in the March 1940 regulations was extension of the control to mortgages. Originally this had been confined to mortgages given by "bodies", but was now re-stated to apply to any person seeking to borrow by way of mortgage or similar loan more than £5,000 in any one year.

At this stage, as has been noted, the effect of control was still very mild and the main achievement of the board was improvement in machinery of control and the gaining of experience in the problems of procedure and evasion which would arise more acutely if control should be tightened. Already, however, there were signs that the machinery as so far developed

[8] Statutory Rules 1940, No. 56.

[9] The regulations used without definition the expression "body corporate or unincorporate" which had a clear meaning in law, but was not the happiest choice in regulations addressed to the public who could be pardoned for believing that an individual might be covered.

would, in that case, face serious problems. There was the obvious point that the introduction of exemption limits of £2,500 for long term capital raising and £5,000 for mortgages would encourage ingenuity in devising interrelated small investments each of which was exempt but which collectively made a unit. The board was aware of this problem from the beginning and commenced to collect data on formation of companies with a capital below £2,500. The close personal contact of its members with a wide variety of business meant that it early became aware of trends in mortgage lending, more particularly the practice of some insurance companies of substituting for normal large loans to building societies small loans to individuals under the exemption limit at higher rates. As early as April 1940, the board warned that extension of this practice would compel control. In the various amendments to the regulations improvements in drafting had been made to cope with the ingenuity of lawyers in devising means of avoidance, a problem which was to become acute later in the year, the leading example being the device of the simultaneous sale of real estate with a contract for subsequent re-purchase at a higher price. Along a different line there were already foreshadowings of the future in various hints that control of the monetary form of investment in itself would prove inadequate, and would have to be reinforced, and in some respects replaced, by control of the real resources involved. Thus in May 1940 the Treasurer suggested to the board that

> . . . now that the effect of the general tightening of control under the Capital Issues Regulations is becoming more evident in the elimination of non-essential forms of investment it is my opinion that methods of eventually exercising a wider measure of control over unnecessary expenditure than can be undertaken by virtue of the regulations should be examined. As the building industry is one of the largest fields of investment it affords a very wide scope for the application of a progressive form of control . . . [but] effective control over building will probably only be obtained by direct prohibition such as the refusal of local authorities to grant permits for specific classes. . . .

A month earlier the board had been framing a statement for the guidance of the trading banks. Throughout, the board, in its handling of bank lending, had preferred to rely upon informal measures of advice and persuasion which had reached the banks through the mediation of Sir Claude Reading[1] as chairman of the Commonwealth Bank. This preserved the established relations between the central bank and the trading banks, and avoided the appearance of a new authority with responsibility for banking policy, while at the same time the powers in the Capital Issues Regulations, and possible amendments, strengthened the hand of the still weak central bank in these negotiations. The specific restriction of bank interest rates, as has been seen, was a concession to political opinion and the board would have preferred even this to be handled informally. The terms of the advice the board wished to give the banks were:

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[1] Sir Claude Reading, KCMG. Dir C'wealth Bank Bd 1927-45, Chairman 1934-45. B. Sydney, 10 May 1874. Died 23 Mar 1946.

1. That the Banks in preference to actively seeking an expansion of their advance business should invest as much of their funds as possible in Commonwealth Government loans.

2. That their approach to all lending transactions should be on the following basis:
   (a) that enterprises which make demands on scarce resources both of men and materials should not be encouraged unless their activity will definitely contribute to the defence programme;
   (b) any shortage of commodities necessary to the Australian economy which could be manufactured here to be advised to the banks from time to time with an intimation that enterprises prepared to embark on work of this nature might be encouraged;
   (c) any proposals which embody substantial expenditure which would create competition for machine tools of types which are in short supply should either be refused or referred to the Commonwealth Bank;
   (d) applications for advances involving imports of equipment or materials particularly where those imports are from non-sterling countries to be approached with caution where there is any doubt such imports are essential to the Australian economy;
   (e) expansion of existing industries producing either for home consumption or export not to be encouraged where such industries cannot be maintained after the war without special protection;
   (f) as a general rule advances for the following purposes should be closely examined before being granted—
      (i) those which will be devoted to purely speculative purposes;
      (ii) commencement or extension of retail businesses, chain stores, cash order companies, hire purchase finance and amusement companies;
      (iii) large building projects especially in city areas;
      (iv) duplication of facilities which are already adequately provided. . . .[2]

This was an accurate summary of the attitude to the problem of control of private investment immediately before the fall of France, reflecting in its various aspects the approach of other authorities, for example that governing exchange control, and the Department of Trade and Customs, to their particular problems. There was still the emphasis on restricting avenues of investment for funds which might be diverted to war loans, while, in determining which forms of investment should be restricted, local production replacing imports was still taken to be *ipso facto* desirable unless there was grave danger of its post-war collapse. Investment depending upon imports of equipment was suspect if the equipment came from non-sterling countries. Beyond this little progress had been made in clarifying what should be regarded for war purposes as relatively inessential, except for the references to machine tools and large city buildings. The special picking out, for instance, of chain stores was more interesting as a reflection of controversy of the 'thirties, when the active competition of expanding chain stores was felt by small shopkeepers, than an illumination of the wartime problem.

In taking these views the board was dependent upon the expression by other wartime authorities of their needs and difficulties. The Department of Supply, for instance, was still unable to give any clear-cut opinions about the particular materials or equipment which, because of the competition of private industry, it found difficulty in securing; and while it was

[2] Capital Issues Board, Minutes 6th mtg 8 Apr 1940.

prepared to express opinions on particular applications to the Capital Issues Board, this was administratively clumsy and only after considerable time could produce any general principles to guide the board. The Department of Trade and Customs was, in accordance with its tradition, actively interested in promoting the development of new industries and rather disposed to see restriction of imports as a glorious opportunity. The Financial and Economic Committee in December advised the board to refuse applications involving an increased demand for skilled labour—which was not very helpful when the difficulties of munitions production over the supply of skill were well-known; while their suggestion to refuse any new venture about which there was "reasonable doubt" was not likely to be favourably received at a time when there was so much concern about unemployment. A month later the attention of the Financial and Economic Committee was drawn to the fact that capital supply from overseas was not subject to control by the board and that freedom given to such enterprises left a dangerous loophole, but this was raised on the committee by the Treasury itself and the discussion went off on to general issues of coordination of economic policy which the board could not have found very useful. The committee's general attitude was that the board should seek advice from the Seaborne Trade Committee, Department of Supply, the Tariff Board and other bodies; this the board was already doing without much success because these other authorities, like the board itself, were still in the process of exploring their problems and discovering what diversion of resources would be required.

CONTROL OF DEFENCE EXPENDITURE

The story of how, and on what, funds were spent is told in other chapters, especially that on supply, but in the early approach to finance there was concern about the policing of spending to ensure that it was really necessary and that it was done efficiently. This issue came to the front immediately because, even as the September budget was presented, expenditure had gone beyond it. In the days that followed, plans for substantial increases multiplied until the financial statement of November 1939 reckoned them at £62,000,000. Of necessity many of these proposals were formulated in general terms. It was not possible, for instance, to be precise about the costs of producing equipment when there had been little or no experience of its production, while it was impossible to expect the Services to provide precise details for plans which would have to be revised as the war took shape, and which were dependent upon political decisions still to be taken.

It was natural, therefore, that there should be serious concern that these multiplying schemes for spending money should be subjected to some sort of overall review and check. The traditional watch-dog of finance was the Treasury; and at the beginning of October the Cabinet approved the scheme for "Treasury control of defence expenditure". This involved the creation of a Treasury Finance Committee to function continuously at the Department of Defence. (The Defence Department was centred in Melbourne and the Treasury in Canberra.) This committee was to be chaired by a senior Treasury officer attached to the Defence Department as liaison officer, together with the three Finance members of the Service boards, and through it would be referred to all proposals for defence expenditure, into which the committee as a body and the chairman as an individual would have the right to conduct enquiries. This committee had the right to veto on behalf of the Treasury any expenditure proposal, which it could then refer back to the Minister for Defence, while the chairman might choose to reserve a proposal for formal decision by the Treasury rather than the committee. If the Minister for Defence adhered to the proposal, despite the committee's verdict, the matter went to the War Cabinet to resolve the conflict, but the minister could meanwhile proceed with the proposal. Completely new schemes involving additions to estimates were, of course, not involved, since these required Cabinet authority, although the very fluid nature of the situation and the inevitable generality of estimates made possible dispute as to whether a particular proposal was covered by estimate already approved or was additional.

Despite the fact that this scheme was defended as being modelled on that operating in Britain, it was unwelcome to the Services, not only because it appeared to involve unnecessary delay and fiddling with figures, but because it necessarily committed the Treasury—traditionally regarded as the department which obstructed by withholding funds—to acting as a critic on technical grounds, that is to requiring that it be satisfied of the necessity of a particular proposal, of its superiority over alternative methods of achieving the same result. It was to be expected therefore that there would be resentment in the Services of this form of control. Charges of unnecessary delay levelled at the committee do not seem to have been justified. In specific instances it appeared that delay was caused primarily by, for example, the army's own machinery for the transmission of papers or by its inability to formulate its own proposals a reasonable time in advance of the time when it wanted to spend the money. But hard-pressed service officers who found themselves without supplies for recruits due to come into camp were not likely to examine critically the statement that supplies could not be obtained until financial authority was forthcoming, while those who had devoted time to the preparation of army equipment and supplies were inevitably restive when insistent civilians from another department presumed to have views on technical matters. On this latter point the Services appear to have had justice on their side.

The challenge to the Treasury when it came, however, was not based upon detailed complaints as to the methods by which the Treasury had exercised its control, but was a frontal attack on the Treasury's right to exercise control at all. It came in the atmosphere of the days immediately before Dunkirk when the War Cabinet accepted the claim that the Treasury Finance Committee was exceeding its legitimate functions by expressing views on questions of service policy and military necessity. The Treasury Finance Committee was promptly abolished, so promptly indeed that there was no plan before the Cabinet for alternative machinery and it was not for another four weeks that a new definition of the Treasury's field of action was approved. It was laid down that the Treasury Committee would stay in being after all but would confine itself to technical financial matters such as rates of pay, when these matters were referred to it by the War Cabinet. In connection with a financial proposal submitted to the War Cabinet the Treasurer was conceded no greater right of comment and criticism than any other minister, while with financial proposals which did not come up to the War Cabinet the Treasury was allowed no authority beyond determining whether the necessary formal steps for authorisation within the Defence Department had been taken, and whether the proposal was covered by existing appropriation or needed a new allocation by the War Cabinet. The Treasury was permitted to retain a representative on the Board of Business Administration who might report to the Treasury on any matter involving expenditure, but this power of report explicitly covered no power to require delay.

This was a signal victory for the Services but its importance is much less than might appear, because of the earlier creation and development, within the Department of Defence, of the Board of Business Administration, which was doing, as part of that department's own machinery, very much the job of independent critic of spending proposals which, when attempted by the Treasury, had exposed this department to so much hostility.

The Board of Business Administration grew out of earlier less formal attempts to provide the Department of Defence with expert advice on business aspects of service spending. The Advisory Panel on Industrial Organisation established in 1938 had discharged this function in some degree, but the panel had been transferred to the Department of Supply and Development on its creation in June 1939, leaving the Defence Department itself without business advisers. This gap was filled in September, after war had begun, by the appointment of two business consultants to the Defence Department. These were Mr Essington Lewis, who was specifically concerned with equipment, stores and munitions, and Mr Norman Myer[3] who was consultant on clothing and textile requirements. They might function, for more general questions of the department's relations with business, as an advisory business committee. When in November 1939 the large expansion of the Services led to the creation of separate departments of Navy, Army and Air, with a central core of the old Defence Department recreated as Defence Coordination, it was necessary to modify these arrangements. The revised organisation was partly modelled upon that of the previous Board of Business Administration established towards the end of the 1914-18 war. The Prime Minister outlined his view:

> It is my desire that the Business Consultants should function as a Board of Business Administration in the Defence Coordination Department, under a mandate to advise on the whole field of Navy, Army, Air Force and Supply Department (Defence) expenditure. The Business Board would be available to advise the Ministers of these Departments and their Boards on proposals, but it would be responsible

[3] N. Myer. (1st AIF: 1 Div Art 1917-19; Lt.) Chmn and Mg Dir The Myer Emporium Ltd, Melbourne. B. Russia, 25 Oct 1897.

to me (the Prime Minister and Minister for Defence Coordination) for the performance of its duties generally, for the investigation of questions referred to it by me, for reporting on the progress of the material side of defence preparations and the efficiency of the machinery for their execution, and for reporting to me on such matters as the Board may wish to bring to my notice.[4]

To the existing consultants, who retained their special fields of responsibility, was added Sir George Pearce,[5] responsible for general administrative matters. The new board was given status and authority by special regulations which included wide powers of enquiry and advice on all matters concerning expenditure on the Services, on the organisation and administration of the service departments in relation to supplies and generally on any matter which any service minister might refer to it or which the board itself chose to raise.[6]

The board functioned with headquarters in Melbourne and met almost every working day throughout the major part of the war. It equipped itself with State business committees to carry out enquiries in the various States and with a staff of mobile inspectors under an Inspector-General whose activities were largely responsible for the success of the board.

Originally the board's enquiries and supervision ranged very widely and might cover almost any problem of supply or administration. It was concerned with questions of acquisition and lease of land (a particularly difficult subject because of the decision that the Commonwealth should not build on leasehold land); with the construction of camps and the victualling and personal equipment of troops; and with a wide range of supplies of equipment, the enquiry into the details of which even took it on to examining and improving procedures for the formulating of demands and placing of contracts. It repeatedly drew attention to instances where standardisation and simplification of specifications could improve speed of supply or reduce costs. It drew attention to the serious consequences for industry of the irregularities of service demands, and supported a policy of accumulation of stocks of clothing and equipment coupled with the installation of systems of stock control. Increasingly, however, this wide range was narrowed until the main interest of the board came to be buildings and construction of them, and also questions arising from the reports of its inspectors on administration of camps and schools of training. It might still on occasion concern itself with various other needs. The development successively of the Department of Munitions and that of Aircraft Production meant that there was available to the relevant Service technical advice of more expert nature than the board could provide, while in any case many of the problems which had concerned the board became the concern of these production departments themselves. Moreover as principles of procedure and techniques were established it became unnecessary for the board to act.

[4] Letter from Prime Minister to Lewis, Myer and Pearce, Nov 1939.

[5] Rt Hon Sir George Pearce, KCVO. Senator 1901-38; Min for Defence 1908-9, 1910-13, 1914-21, 1932-34, Home and Territories 1921-26, External Affrs 1934-37; Member Bd of Bus Admn 1939; Chmn 1940-48; Memb Grants Commn 1939-44. B. Mount Barker, SA, 14 Jan 1870. Died 24 Jun 1952.

[6] Statutory Rules 1939, No. 182, 22 Dec.

In all these enquiries and reports the board was concerned primarily with the efficient spending of money, and all its attention to the specific details of this or that project was subordinate to that end. It was therefore carrying out from within the service departments a function which the Treasury Committee had been less favourably placed to do. Indeed, in time, this situation was recognised by the transfer of the board, in February 1942, to the Treasury, but by this time the board had established itself with the Services and could continue to function, nominally from without, and not arouse the old hatreds.

It did not achieve or retain this position without difficulty. Initially there was a good deal of suspicion by the Services and a disposition to feel that they were being put upon the defensive, but the members of the board were able to overcome this attitude. One important factor was the determination of the board to avoid all publicity for its activities so that service officers need not fear that ammunition for outside critics, of whatever party colour, would be supplied by the board; in fact they were made to feel that any criticism from the board was a domestic family matter within the department. Moreover, the board was very insistent that there should be no delay in the board's examination of proposals. Wherever it felt that the main lines of a proposal were justified but the details needed enquiry, it would authorise the commencement of the project while enquiry was in progress. Increasingly it promoted informal consultation in the process of formulation of proposals, so that finally the formal examination was formal indeed. The system did not always work without friction. In 1940 the very success of the board as a critic led to instances of attempts to bypass it by transmitting expenditure plans to the Treasury before they had been to the board, and by making initial direct arrangements with the Department of Supply before the board had dealt with the items. There was special difficulty with the air force, mainly because of the reluctance of that department to recognise that its standard of equipment, buildings and personal services were not only out of line with those of the army but on occasions conspicuously excessive. But on the whole the board's early record was one of a successful combination of good relations with the Services and execution of its main object of ensuring economy in expenditure.

The inauguration of capital issues control, the curtailing of Treasury control of defence expenditure, and the rise of the Board of Business Administration, were the working out at the level of administration of the policy of the November 1939 budget. Meanwhile, however, there were doubts and discussions about the principles of policy, not merely in the restricted field of finance, but over the whole organisation of a war economy. The upshot was the remarkable episode of what might be described, not inappropriately, as the Menzies seminar, that is the presentation to the Economic Cabinet, by various leading ministers, of memoranda on economic policy. These memoranda ranged over many aspects of war economics, but their dominant theme was finance and accordingly they are discussed here.

The first session was on 16th February 1940 when the Prime Minister read a memorandum to the Economic Cabinet to be followed by the Acting Treasurer and the Minister for Commerce. After discussion it was decided that other ministers, especially those for Trade and Customs and for Supply, should present memoranda at a subsequent meeting. In the event this later discussion did not take place until the meeting of 11-12th March. The documents preserve the essence of thinking on finance by senior sections of the Executive at this period.

The Prime Minister's memorandum reflected his preoccupation at this stage with the question of coordination as he saw that problem of economic policy. What he hoped to achieve by the discussion of these memoranda was indicated by his statement that "before we decide to catch any bus we should at least find out its destination and whether it is going on a journey that we really want to take". He sketched his impression of key departments with widely divergent approaches to wartime economic questions planning to send their own particular "buses" on quite unrelated trips. The Department of Trade and Customs was obsessed with war-created opportunities for the establishment of any and every new industry. The Department of Air was hostile to all industrial development since it would make impossible their difficult task of recruiting skilled man-power. The Treasury fixed its eyes on purely monetary questions aiming "to maintain investible funds so that public loans may be filled; to keep interest rates down; and to encourage the stability of industry so that taxation yields may be high". The Department of Commerce was on the one hand organising profitable sales to Britain, and on the other hand developing somewhat extravagant ideas for the expansion of rural industry, with consequential suspicion of industrial expansion. It was the Prime Minister's view that these divergences must be reconciled, and, clearly, he hoped that an apparently academic discussion in the Cabinet would achieve this end.

Insofar as he indicated his own views they were implied in his praise of the combined work of the Treasury and the Commonwealth Bank. In this connection his comments were foreshadowings of the gradual departure that was to be made from Spender's principles of November 1939. Menzies' discussion ran entirely in terms of money, with scant reference to the real resources, control of which was the essential problem. He placed great emphasis, for instance, upon investment control to ensure the filling of public loans; and the passage quoted above concerning maintenance of industry in order to sustain taxation yields embodied a convention of thinking which was to become increasingly prevalent among members of the Government.

The memorandum from the Acting Treasurer showed the clearest appreciation of what a wartime economy involved, a clarity which was undoubtedly due to Spender's willingness, already noted in connection with the November budget, to seek advice and views from the Financial and

Economic Committee, and his readiness to discuss issues with its chairman rather than to accept the traditional approach of Treasury officials. He drew attention to the danger of attempting too much and the risk that Australian commitments for manpower and plans for war production would fail by being spread too widely. He expressed the view, which was already beginning to have a number of adherents, that a state of full employment would be reached in the near future. Events were to belie this forecast, although, had the execution of production plans been pressed ahead vigorously, the forecast would have been justified. It was Spender's view that cuts in consumption would be necessary if inflation were to be avoided. Control over private investment he presented not so much as a monetary device for filling loans as an instrument for restricting use of manpower and materials in non-essential activities so that they might be available for war. He emphasised, consistently with this, that the restriction of imports was encouraging indiscriminate growth of new industries which in his view ought not to be permitted unless their wartime value could be established. He foreshadowed the need to ration materials, to tighten up the restriction of non-sterling imports, to ration petrol. Returning to the theme of finance and the objects of avoiding inflation, he urged that substantial increases in taxation, "severe enough to prevent inflation", should be submitted to Parliament promptly.

The other memoranda before the Economic Cabinet made a notable contrast with these two. That from the Minister for Trade and Customs started well with what seemed like echoes of Spender's view about the approach of full employment, about the need to control private and government investment with an eye to the real resources used instead of freeing money for government loans, but his reiteration of the need to further cut non-sterling imports formed a bridge to lengthy discussion of the attitude of his department to industrial development. This fully merited the stricture of the Prime Minister, for, after making a proper genuflexion to the paramount needs of war in deciding what new secondary industry should be permitted or promoted, he gave reasons which in total amounted to nothing less than welcome for any new industry. The Minister for Commerce in his own different field had a similar approach, seeing great opportunities for the expansion of rural industry based upon far-reaching irrigation and electrification programmes and with his eyes fixed steadfastly on the post-war period. The Minister for Social Services and the Postmaster-General similarly were looking well ahead, and perhaps the only contribution to wartime problems was Sir Frederick Stewart's[7] proposal for the introduction of unemployment insurance, and even that was seen as a desirable social service rather than as a wartime device for draining off purchasing power or making wartime restriction of civilian employment more palatable.

All the ministerial memoranda had been referred to Sir Ernest Fisk as Director of Economic Coordination, and the second meeting of the

[7] Hon Sir Frederick Stewart. MHR 1931-46; Min for Commerce 1932-34; Min for External Affairs, for Health and Social Services 1940-41, for Supply 1940. B. Newcastle, NSW, 14 Aug 1884.

seminar had his views before it. It can hardly be said that these advanced the discussion or clarified the problems. So far as the Cabinet was concerned the outcome of the whole discussion was nebulous. Perhaps some ministers may have learned something; perhaps their advisers may have been compelled to think out their attitudes a little more fully, but subsequent months showed little evidence of that. The Economic Cabinet took no decisions beyond the original sweeping reference to Fisk who was empowered to follow up the various issues of coordination which had been raised, with freedom to seek the views of any government organisation. That was hardly the way to achieve "coordination", and in any case Fisk was not the man to do it. Confronted with problems of a type completely foreign to his whole background and experience, characteristically he fell back upon vague generalities about the making of surveys and the seeking of information; coordination as between government departments demanded patient negotiation and conciliation, which one who had commanded a major business enterprise could find only confusing and frustrating.

Even more, the outcome signified the failure of the Economic Cabinet.[8] These might have been vital weeks in the formulation of wartime economic policy, but the Economic Cabinet, established only in the preceding November, fumbled this, the most important issue presented to it, and as a body achieved no more than the registration of the absence of any common framework of thought in the Government as a whole.

Meanwhile the only minister who had had a clearcut and consistent view of what the problems of a war economy were to be, had, in his own field, his own way. In May Spender, now Treasurer in name as well as in fact, was able to present to Parliament a financial statement which embodied substantially the views on finance which he had put forward in his memorandum, and at the same time to initiate action designed to restrict, through the agency of the Loan Council, public works spending by State and local government. The specific proposals of his financial statement, like his memorandum to the Economic Cabinet, bore the impress of the Financial and Economic Committee which, ever since the November budget, had continued the discussion of the desirable development of financial policy and had canvassed various specific measures.

Between November 1939 and the following May the keynote of the discussions in the Financial and Economic Committee was the need to devise that taxation which, according to the November budget speech, was part of government policy, and to have it progressively adopted. "The problem is, of course, to persuade Cabinet to accept taxation" was the theme of discussion on 16th December.[9] Increasingly it became clear that the acceptance of more taxation would be very unwilling indeed, and the committee devoted a great deal of time to discussion of expedients which would achieve the same substantial result of draining off purchasing

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[8] See also discussion in P. Hasluck, *The Government and the People, 1939-41* in this series.

[9] Phrase from Minutes.

power, but might be disguised or coupled with devices to make them more palatable.

Thus in December it toyed with a general excess-income tax as an alternative to the Government's disposition to adopt a modest excess-profits tax as a political gesture; compulsory loans were considered (the first of several occasions), the committee regarding them as a poor substitute for straight-out income tax, but better than no increase in tax. Unemployment insurance on a contributory basis was explored, and an amalgamation of unemployment insurance and compulsory loans into a version of Keynes' deferred-pay plan—then being widely discussed—was rejected primarily on the ground of the impossibility, in the framework of Australian politics, of making it work according to plan.

By January the committee was stressing the need to tax in order to restrain consumption, and moving on to analysis of the future prospects of government loans. This was a refreshing change from the Treasury approach, for it placed its emphasis on measures to promote increased saving rather than the negative line of stopping other channels of investment. Included were ideas for pressure on primary producers, whose incomes were inflated by export prices, to reduce their indebtedness, with the alternative of withholding, until after the war, portion of the receipts from exports. In March 1940 the committee discussed at length means to make greater funds available for loans, but their approach made a marked contrast with that embodied in the Capital Issues Regulations, being directed at the real resources on which the money was spent; for example, a cut in building by one-third and a similar reduction in car imports were considered. The tenor of the discussion was that restrictions even on this scale, which had little chance of acceptance at this time, would still leave more than £30,000,000 to be found by additional taxation of incomes, as well as £10,000,000 from land tax and estate duty, and a tax on business profits.

Reinforcing these discussions of the Financial and Economic Committee went a hardening of the attitude of the Commonwealth Bank against any heavy reliance on central bank credit, and its rejection of approaches from the trading banks for adoption of the technique of 1914-18, when the banks were encouraged to make liberal advances to customers for the purpose of war loan investments. The committee continued to hammer away at its dual doctrine: the necessity of increased taxation, and the need to attack private investment as a real rather than a monetary question. Its main discussion was contemporaneous with the Economic Cabinet seminar, but its only reflection there was in the memorandum from the Acting Treasurer. Nevertheless, the willingness of Spender to listen to the committee was decisive for its influence.

THE FINANCIAL STATEMENT OF MAY 1940

In April the Governor-General's speech foreshadowed the implementing of the second phase of the Spender financial programme:

> The principal object of the present session of Parliament is to make such provision of money as will enable our war effort to be financed. . . . [The Government] are resolved to avoid the evils of monetary inflation, since it imposes unjust and inequitable financial burdens particularly upon the wage and salary earner, destroys public confidence, is destructive of savings, and would lead inevitably, if pursued, to financial collapse and post-war depression. In view of the approach to conditions of full employment of our resources, my advisers will, in this session, direct particular attention to further taxation measures and the authorisation of war loans.[1]

Presenting a financial statement in May, the Treasurer explained that the purpose was to give adequate warning of stiff increases in taxation to take effect in July. After reviewing previous financial measures he proceeded to a summary of the manpower position—thus to some extent neutralising the continued insistence on "conservation of [financial] resources".[2] Total employment was estimated to have risen by 80,000 or four per cent of the working population, between August 1939 and February 1940; the Services estimated an intake of 50,000 between January and July 1940 and a further 60,000 in the following twelve months. In the light of war production plans it was believed that "all probabilities point to the conclusion that we shall soon have no reserves of unemployed manpower, at least of the kind which can readily be employed".[3] The rising liquidity of the banks and the decline in interest rates pointed to the same conclusion.

Nevertheless the experience of under-spent defence votes and the dominance of fear of unemployment combined to produce some hesitation: "The Government is proposing finance only for that part of our commitments which it is confident will be carried out before the end of June 1941. It is therefore satisfied, and has been at trouble to ensure, there is no danger that it will over the year as a whole take more from the public in loans and taxation than it will spend on the war programme."[4]

"All considerations," it was concluded, "point therefore to the advisability of relying upon taxation and public loans to obtain the funds required by the Government in the period immediately ahead. The advantages of this course may be summarised as follows: (1) the transfer of resources to defence activities can be more systematically effected and the burden upon the community can be more deliberately and more exactly apportioned; (2) the diversion of purchasing power from private to public uses is the only alternative to inflation, and at the same time it conserves essential overseas resources by reducing the demand for imports."[5]

The yield from customs and excise had proved much better than forecast, mainly because of a steep rise in imports from an average of £7,300,000 a month in September-December 1939 to £11,700,000 a month in January-March 1940. The explanation was that the natural desire of importers to rush stocks in had not met the expected difficulties

[1] *Commonwealth Debates,* Vol. 163 pp. 6-7, 17 Apr 1940.
[2] *Commonwealth Debates,* Vol. 163 p. 469, 2 May 1940.
[3] *Commonwealth Debates,* Vol. 163 p. 470.
[4] *Commonwealth Debates,* Vol. 163 p. 471.
[5] *Commonwealth Debates,* Vol. 163, p. 473.

in shipping and supply. For 1939-40 the November estimate of customs revenue for the year was raised by £7,000,000 and other items by £1,000,000. For 1940-41 it was estimated that £16,000,000 would be available for war expenditure from revenue, if current rates of tax were unchanged. War expenditure from the beginning of the war to the end of the financial year 1940-41 was estimated at £125,000,000 in Australia and £35,000,000 abroad.

Following the loan of £6,000,000 sterling raised in London in June 1939, it had been arranged that the amount needed to the end of 1940 should be provided by loan from the British Government at the same rate as the British Government was itself paying. The Treasurer commented: "If overseas finance is to be provided by Australia itself without resort to borrowing from the British Government, not only must the necessary amount be raised in Australia by borrowing or taxation, but also sufficient London funds must be amassed in the Australian banking system. With reluctance, the Government has decided to defer for the present the question of providing funds in Australia to meet any portion of the overseas expenditure in 1940-41. In the proposals which I am about to make I am, accordingly, leaving out of my calculations the whole question of overseas war finance. I emphasise, however, that this question must be faced at a later stage."[6]

For the remainder of 1939-40 it was estimated that £7,000,000 still had to be found, and for 1940-41 expenditure on war was set at £79,000,000, a total of £86,000,000, towards which existing taxes would provide £16,000,000. Therefore £70,000,000 of new money had to be found and it was proposed to find £50,000,000 by public loans and £20,000,000 by additional taxes. Ordinary company tax was not modified but two new taxes were planned, a wartime company tax and an undistributed profits tax,[7] applying to companies only and estimated to yield £5,300,000 a year when fully in operation. The latter proposed to levy 1s in the £ on undistributed profits, after allowing deduction of all other taxes and exempting one quarter of amounts undistributed. Yield was estimated at £575,000. Personal income taxes were increased to yield a further £4,000,000 or nearly fifty per cent more. The main burden fell on the middle incomes. The exemption limit of £250 for a single man plus £50 for each dependent was retained, while the divergent levels of State income taxes dictated restraint in increases at the top of the scale.

Land tax rates were doubled to give a further £1,500,000. Estate duties were raised, to yield, when fully operative, a further £850,000. Sales tax was moved from 6 per cent to $8\frac{1}{3}$ per cent, giving a further £5,000,000. Customs and excise on petroleum products were raised to provide a further

[6] *Commonwealth Debates,* Vol. 163, p. 475.

[7] As originally proposed excess over 8 per cent paid—

excess over 8	per cent	up to 9	per cent—	4 per cent
9	,,	,, 10	,,	8 ,,
10	,,	,, 11	,,	12 ,,
Maximum, over 22	per cent—			60 per cent

A tax on undistributed profits was among suggestions from a Committee of the Commonwealth Institute of Accountants to the Treasurer in March 1940. *Herald* (Melbourne) 5 Mar.

£3,300,000, and a special war duty on all imports, other than petroleum and imports free of duty, of ten per cent of duty otherwise payable was estimated to yield £2,000,000. In total, and allowing for some delay in receiving the full yield of some of these taxes, additional revenue for 1940-41 was calculated to reach the desired total of £20,000,000.

Changes in the financial programme followed fast. In June authority for a further £20,000,000 of loan money was sought, the primary purpose being the development of a drastically reorganised munitions programme after the fall of France. Special arrangements were made to accept offers of interest-free loans on the understanding that repayment during the war or some longer agreed period would be possible if lenders were in difficulties. With an excess of caution the amount was limited to £5,000,000, although two months later 18,268 individuals had thus subscribed £4,743,009, the largest single amount being £260,000.

LOANS AND THE COORDINATION OF COMMONWEALTH AND STATE WORKS

Despite the inclusion in Spender's financial proposals of increases in taxation, it was still true that main reliance was placed upon loans, and this brought into sharp focus the growing view that serious restrictions of State loan expenditure must be achieved. As has been seen, the State governments had succeeded in obtaining virtual exemption for themselves and local authorities from the operation of capital issues control. Nevertheless there was continual pressure from the Capital Issues Board who drew attention to the large gap that was created in the control; the board stressed the competition between borrowing of local bodies and the Commonwealth Treasury, and the difficulty that was created in reducing interest rates in these conditions. At this stage the question was still considered primarily as a problem of competition for money rather than real resources, and especially of maintaining low interest rates.

Behind the reluctance of the States to make any concessions lay, on the one hand, their concern about unemployment. A major part of the works which they carried on were commonly described as "relief" works in recognition of the way they were used to provide whole or part-time employment for unskilled labour. Thus it was estimated in April 1940 that in New South Wales alone there were about 8,000 men employed full-time on State works financed by loans and a further 14,000 on part-time relief work. On the other hand the States were unwilling to retire in favour of the Commonwealth from fields of activity which were traditionally theirs.

In pursuance of the view expressed at the Menzies "seminar" that there should be immediate proposals to Parliament for increased taxation, the Treasurer sought the views of the Financial and Economic Committee about the amount which might be raised by public loans. The committee answered the question at length to the general effect that about £30,000,000 might be so found on various conditions. The most important of these was a cut in works expenditure, other than for defence, by one-third, which would fall mainly upon the States and local authorities and, if this were to be enforced, would create serious difficulties for them and therefore political difficulties for the Commonwealth in its dealings with the States.

It was at this stage that a group of temporary recruits to the Commonwealth Treasury urged a new approach to the States. The view which they put forward was that unless the States were pressed to reduce these works they would be disposed to carry them on indefinitely, especially because the depression years had built up a state of mind among the workers concerned which made it unlikely that they would of their own initiative take advantage of the new employment opportunities created by the war. At the same time it was politically essential to organise placement of these men in other employment if State works were reduced. Their proposal was at this stage no more than one for direct discussion between State and Commonwealth Treasury officials, but it was taken up with vigour by the Treasurer, who submitted it to the full Cabinet as part of the general financial discussion on 9th April 1940.

He urged that the States be requested to weight their loan expenditure for 1940-41 more heavily in the early months in expectation that war expenditure would later be increasing rapidly. The Defence Department was to be urged to speed up construction work, while the States' labour exchanges were to be notified of such works within their own boundaries and asked to reorganise their activities towards placement rather than relief. The Treasurer obtained authority to take up with Federal departments the speeding up of construction work for war purposes and to open negotiations with the States along the lines he proposed.

Accordingly information was sought from the Services, the Department of Supply and Development and the Department of the Interior (at this stage the principal construction authority for the Commonwealth) about their works programmes, and the possibility of speeding them up. State Premiers were notified of the policy embodied in the Cabinet decision and invited to supply detailed information of their works programmes for 1940-41, together with statements of the extent to which these could be adapted to employ labour not absorbed by the defence programme, the degree to which State construction authorities could undertake for the Commonwealth the execution of works, and the adaptability of labour exchanges to the task of directing labour into defence activities. The departments were not able to supply the kind of information which was sought, while the States did not supply sufficient information to form the basis of specific proposals. This was not entirely their failure since, for example, the Department of Supply and Development could not say how its programme for buildings, plant and equipment—then estimated at £14,000,000—would be divided between the States, while army programmes could not be obtained at all.

Accordingly the whole question of what was coming to be called "coordination of works" went to the next meeting of the Loan Council without these various enquiries being completed, but with the Commonwealth having a very precise plan ready to put to the Premiers.

The Loan Council, consisting of the Prime Minister and the Premier of each State, had been embodied in the Financial Agreement of 1928 between the Commonwealth and States, being built upon an earlier advisory council. The basic idea, as originally conceived, was to minimise competition in the loan market between the various governments. Its purpose was to pool information about programmes for the raising of loans so that agreement might be reached about the total amount to be sought and its distribution between governments. In accordance with the new arrangement about existing debts covered by the Financial Agreement, it was intended in general that the total of loans agreed upon should be raised in the name of the Commonwealth. The agreement did not cover Commonwealth loans for defence and war, although the practice was that these were reported to the council since they would naturally influence estimates of the total amount the loan market could provide. Nor did it cover borrowing by statutory and local government authorities. The subsequent history of the council was much influenced by the events of the economic depression of the 'thirties in which various forms of discreet avoidance of council control were developed by State governments, particularly through local government finance. It is doubtful if the council did anything to reduce the total volume of borrowing, although it may have cheapened it by eliminating open competition in the market. It acquired a quite inordinate respectability in the London money market, and within Australia certainly did provide a regular opportunity and a formal procedure for consultation between governments, which was valuable even when they did no more than agree to disagree.

The council met on 27th May 1940 in the shadow of the collapse of the Western front in Europe, and while it was meeting the Belgian army capitulated and the evacuation of Dunkirk commenced. The impact of these events was reinforced by the fact that the Commonwealth came to the council with a precise plan which envisaged a positive role for the States. The core of the plan was the appointment of a coordinator of works, to work with the States and with Commonwealth authorities for the production of a programme of works which should give priority to defence needs and at the same time protect the interests of the States' uncompleted projects and the States' political obligations in respect of unemployed, for whom the defence programme did not provide. The States were offered the responsibility of exercising approval over all works carried out within their boundaries by statutory and local government authorities for Commonwealth purposes in the war programme. It was recognised that the scheme would take some time to come into operation and that the States would not have funds to carry on in the meantime, and the Commonwealth undertook to provide these.

The Premiers received the proposals with cautious willingness to consider them, their main reservations concerning the problem of choice of a coordinator of works and the possible long-term implications of the plan. The following day the council agreed to all the essential points of the plan, and specified that the council itself should appoint a coordinator of works and that the plan was to be reviewed at the end of twelve months and should not, in any case, extend beyond the duration of the war.

After the discussion of various names choice for the office of Coordinator of Works fell upon Sir Harry Brown,[8] who was appointed, and equally promptly he proceeded to work. Apart from the more obvious difficulties of high policy as between Commonwealth and States, he found his path obstructed by problems of procedure in relation to works programmes: the difficulty of attaining any satisfactory classification which could apply to the varied information supplied by State authorities; and the application of estimates and departmental accounting which had only complexity and obscurity in common. He found it difficult to get information in a useful form, that from the States being too often expressed in purely financial terms, such as whether expenditures were for "purposes other than for deficits", or whether they were to be met from revenue, and so forth, while that from the Services was often in terms too vague and general, for example, "parade grounds", "inland defence roads". There emerged a number of instances of the Services persisting with activities which could not be regarded as essential, such as "South Head, paths and tree planting". He also became increasingly impressed with two problems: on the one hand the risk that the continuance of works of some defence value and low priority would create serious scarcities, and on the other hand the disturbing lag between proposals for expenditure on defence works and the actual expenditure.

When the Loan Council met again in August 1940 the Coordinator's report drew attention to the difficulties inherent in coordination as applied to government works. The upshot of council consideration was to reduce the total loans to be borrowed for works for the year 1940-41 from £24,000,000 to £17,000,000, with a proviso that this decision should be reviewed in December. In the event it was not the nominal cut in expenditure which occasioned vigorous discussion but the lag between authorisation and expenditure, which was shortly to become a major issue.

[8] Sir Harry Brown, CMG, MBE. Dir-Gen Posts and Teleg 1923-40; Chmn British Gen Elec Co. Pty Ltd 1940-53; Coord-Genl Works 1940-45. B. Hylton, Eng, 28 Dec 1878.