The Treasury vs the Bank: The post-war fight for credit regulation and industry

The following is a summary of a 2021 article by Dr. Evan Jones, Research Associate at the Department of Political Economy at the University of Sydney, in which he documents how the history of the post-war economic boom has been rewritten. The original article, titled Macroeconomic and Structural Policies: Economic policy in post-World War II Australia*, was published in the Journal of Australian Political Economy, No. 88. All quotations are from Jones unless otherwise identified.*

In the eyes of neoliberal economists, the only accepted role for governments is to get out of the way, a function, writes Jones, "oriented towards destroying the impediments to the free operation of 'the market'."

Under this mentality, allowable interventions amount to adjusting mechanisms such as interest rates, actions that are a step removed from direct regulation of the levels of credit which are the object of the policy. But we see today that such an approach, writes Jones, can have an "adverse structural impact (as on the housing market)".

Claims that such hands-off mechanisms were responsible for the post-World War II boom and near-full employment come from an "ideologically influenced mindset which has narrowed and distorted" reality. History shows that government interventions "are the motor force of national economic development—an axiom little understood by countries suffused with liberalist ideology."

In 1945, with the prevailing "developmentalist" mentality and a federal public service "invigorated with skilled personnel", the Labor government set out to renew basic public infrastructure and social welfare. The simple, but today controversial, notion that public capital expenditure could supplement private capital expenditure, was a critical factor. A National Works Council was created in July 1943, drawing up a priority list of infrastructure projects.

The Commonwealth Reconstruction Training Scheme for returned services personnel opened in January 1944 and the Commonwealth Employment Service was created in January 1946. The *Banking Act of 1945* (which ruled that the government was the ultimate arbiter of monetary policy) had "committed the restructured Commonwealth Bank to the pursuit of full employment". It was teamed with the 1945 White Paper, *Full Employment in Australia,* a document considered quite heretical in a world still gripped by the austerity policy of the 1930s Depression era.

Full employment was accepted as important, even at the expense of some inflation, which was creeping up due to shortages of labour, material and equipment. There was much debate about whether the government could or should determine where the available resources should most usefully be deployed. Wartime controls were still available to do so, but the Capital Issues Advisory Committee (CIAC) had been charged only with approving capital issues for enterprises engaged in the war effort. The chairman J.K. Jensen of the Secondary Industries Commission (SIC), to whom the matter was referred, was wary of privileging incumbents and inclined to "let competition take its course".

Essential industries and advance policy

Some control over investment was perceived as necessary in the early reconstruction period, so dialogue ensued about which industries could be fostered on the grounds they were "oriented to post-war conditions". At the same time, Commonwealth Bank Governor H.T. Armitage wrote to the Treasury Secretary, asking for directions regarding "advances policy"; that is, what kind of loans were to be favoured. Private investment was already taking over from public works, so "an advances policy consistent with general government policy on industrial development" was seen as necessary so as not to divert scarce resources and labour from vital deployments. The Bank "requested a comprehensive review of industry and directives on industrial priorities".


Commonwealth Bank Governor, 1941-48, Hugh (H.T.) Armitage.
Photo: RBA

The veritable Treasury representative on the CIAC board, W.C. Balmford, argued that the government should come up with an explicit policy on which industries to support, or "dismantle the Control machinery" altogether. In a 1947 memo he wrote that "Industry is quite capable of looking after itself", arguing against what is known today as picking winners by "favouring the existing and possibly less efficient concerns. How can anyone determine beforehand which is going to succeed—the most promising ventures have been failures, and vice versa?"

There are some striking parallels with today. Following years of war-time deprivation, consumer spending was booming, families were growing, savings were being spent. Latent demand was unrolled but production of basic materials was constrained by locational factors, labour and housing shortages. Inflation was becoming an issue. A paper on the "Direction of Private Investment" by the Investment and Employment Committee (IEC), the vehicle dedicated to bringing the government's commitment to full employment into reality, recommended an investigation into manufacturing. This was pursued and detailed reports were produced on key industries.

A "selective advance policy" was finally recommended. A Treasury letter to the Secondary Industries Commission, signed by Prime Minister Ben Chifley, stated that "bank advance policy has to be tightened up", by the Commonwealth Bank, but "it has to be selective". The IEC concurred, and the Secondary Industries Division researched the "conceptual underpinnings" of industries essential to the Australian economy.

While these agencies were still at the drawing board, the Commonwealth Bank moved on its own to issue a directive on advances. Sectors like agriculture that were booming were to be somewhat restrained and those that needed a boost, such as building and building materials, to support desperately needed housing construction, were supported. Investment in industrial equipment was encouraged and consumer purchases were discouraged.

The policy stated that "Banks should not finance new enterprises, or the expansion of existing enterprises:

(1) where the production is not essential to the Australian economy;

(2) where the added capacity is likely to increase production above ultimate demand;

(3) where production is likely to be uneconomic in the long run because of excessive costs, or other factors."

Prime Minister Ben Chifley in 1948 at the Fisherman's bend General Motors-Holden factory—an example of industries supported by selective banking policies. Photo: National Archives of Australia, A1200, L84254

Treasury and the banks intervene

The policy was leaked to the media, and controversy broke out. Commonwealth Bank Governor Armitage blamed the banks. The banks were enraged that the Commonwealth Bank's central banking arm "had been given a powerful mandate in the *Banking Act of 1945*, but the culture that underpinned the selective advances policy was nurtured during the War when the trading banks were *de facto* arms of the state. Armitage was mindful of the loyalty of the British trading banks to the Bank of England, expecting the same from the Australian banking community."

"The policy debates in the late 1940s highlight that economic policy instruments were not derived ready-made from some theoretician's cookbook. Rather, much was initially attempted with grand intentions, but the instruments evolved pragmatically."

(Note that this was around the same time that the neoliberal global umbrella thinktank, the Mont Pelerin Society, was being fashioned, whose job it would be to try to steamroll politicians into line on economic policy. Jones later alludes to this apparatus, with regard to one of its subsidiary thinktanks the Institute of Public Affairs.)

Nevertheless, measures such as tax increases, currency revaluation and interest rate increases were dismissed as a means of tackling the overheating economy because they would conflict with other goals such as financing the war debt, increasing private capital expenditure and home purchases. Instead so-called "structural policies" (which change the structure of the economy directly) and war-time measures such as Statutory Reserve Deposits (which dictated a percentage of deposits banks had to keep at the RBA) were proposed. The Commonwealth Bank noted difficulties with selective advance polices due to disagreements on what constituted "essential" industries. An insightful Treasury researcher had noted in a memo that "to frame [a Central Bank] advance policy meant the framing of an industrial policy, the two being really different aspects of the same thing". Disparate views, however, blunted the effectiveness of the policy. This worsened after 1950, "given the almost hegemonic authority of Treasury over economic advice following bureaucratic restructuring under the Menzies government."

Overreliance on private agencies as a conduit to effect discriminatory policies, from banks to BHP, and their demands for private profit in conflict with the national interest, was another factor that interfered. Private capital also protested at Bank control over capital issues. "A deeply rooted philosophical liberalism was (and is) manifest in a wariness of hands-on structural discrimination in Australia. Herein is the tangible workings of *laissez-faire* as an embedded ideology—endlessly discussed and praised as a principle but rarely analysed sociologically in its substantive and comparative impact."

The post-War "planners" faced difficulties also due to the nature of Federation, which limited Commonwealth authority over the States, but a 1945 referendum to change it failed to get up. The planners "faced the erection and expansion of a propaganda network painting their prospective better world as dystopian. The movement began in October 1942 when Melbourne businessmen established the Institute of Public Affairs. ... Curiously, 'individual freedom', not at risk, was emphasised rather than States' rights." The "propaganda machine was extensive and hysterical" by 1949 with Chifley's effort at banking sector nationalisation which "fed into the liberalist meme of the sanctity of 'individual freedom', even that of democracy itself."[1]

Despite all of this, the Commonwealth Bank continued to exercise controls over capital issues, import licensing, export controls on certain rural and mineral commodities, rent and price controls, and some rationing of essential products (until 1950). While the Menzies Government initially dismantled most of these controls, it reimplemented many of them out of economic necessity and for defence purposes.

Documentation of the Commonwealth Bank's qualitative advance policy is very sketchy, as is that of other discriminatory policies. There is evidence of bank policy having a "deterrent effect on ill-considered and speculative offerings". While advance policy was supposed to terminate in 1952, the Bank persisted with selective actions until the early 1960s. Not all aims were achieved, but there was significant expansion of engineering and chemical sectors, along with production of basic commodities. As the economy underwent "a dramatic qualitative transformation to a deeper level of industrialisation", demand increased and strains were inevitable.

Debate continued under the new Menzies government, with the Minister for National Development and Works and Housing, R.G. Casey asking the Treasury Secretary "if there remains any machinery or control by which investment can be directed into channels that the Government believes to be useful and necessary, and discouraged from directions which are unnecessary—i.e. into basic industry as against luxury industry." The Treasury's deceptive reply downplayed the options available, noting only the Commonwealth Bank's advance policy: "I would say there is no other machinery of controls which could be used to direct investment." This neglected significant Coalition interventions including to support rural sector development, "symbolised by an enlarged and refashioned Snowy Mountains Scheme". The Coalition government dissolved the Department of Post-War Reconstruction, and the Treasury "readily filled the vacuum", becoming the dominant voice for "respectable economic opinion" and thus distorting an "understanding of the complex character of the policy process". The role of government in creating the growth era was obscured. "The character of the period has been obliterated—the strategic vision, the problems faced, the difficulties surmounted and the failures."

As Jones concludes, "the historical record has been rewritten implicitly to suit intellectual and ideological interests. The process of economic policy making has been dramatically narrowed and rendered mechanistic and antiseptic."

1. "When fascists cried freedom to protect the banks", *AAS*, 6 Oct. 2021.