



ECONOMIC INSANITY

Finance policy Gough Whitlam and his incompetent cabinet wreaked havoc on the national accounts, writes former secretary to the Treasury **John Stone**.

Gough Whitlam's death has evoked the usual hagiography from his ever-zealous band of true believers. A proper respect for the dead and respectful sympathy for a man deprived, in 2012, of the companionship of a loving wife of 70 years, will also greatly mute any more critical views.

Yet Voltaire famously said the only thing we owe to the dead is the truth, while Santayana noted that those who cannot remember the past are condemned to repeat it.

So without, I hope, traducing Mr Whitlam personally, this article seeks to assess his effect on our economy during his three years as prime minister.

Make no mistake: I hope to show – and abundant other evidence testifies – that the Whitlam government's performance was dominated throughout by Whitlam himself, "hands on" to the nth degree.

Shortly after the December 2, 1972, federal election (in which, regrettably, I voted for Whitlam), the Treasury secretary Sir Frederick Wheeler, head of the general financial and economic policy division Bill Cole and I, deputy secretary of the economics division, had our first meeting with Whitlam and his personal advisers. As Cole said, with our agreement, it was a pleasure to deal again with someone who, unlike his predecessor, seemed like a prime minister.

Before the election Treasury had prepared, under my direction, the "black book" – papers on which we thought the incoming government needed to be quickly briefed. (Lest it be thought that preparing such papers was in some sense "political", the same "black book" would have been presented to William McMahon and his treasurer had the Coalition won the election).

Most urgent of these papers was one deal-

ing with the exchange rate. Hard to credit though it sounds today, Australia's balance of payments current account had swung from a 2.1 per cent of gross domestic deficit in 1971 to a 0.9 per cent of GDP surplus in 1972.

Our exports (and our assets) were being sold too cheaply, and our imports bought too dearly. Treasury also saw that, should Labor win the election, its extensive spending program would place pressure on domestic resources. By giving greater access to imports, an appreciation of our dollar (then pegged to the US dollar) would relieve that pressure somewhat.

On December 19, Frank Crean was sworn in as treasurer. Two days later his cabinet submission on the exchange rate was considered by Whitlam, deputy prime minister Lance Barnard and Crean only, and on December 23 Whitlam announced a 7.05 per cent effective appreciation of the dollar. Relations between Whitlam and the Treasury thus got off to a flying and thoroughly harmonious start.

Given the economic destruction his government was to wreak over the next three years it is also fair to say Whitlam then appeared open, indeed receptive, to sensible economic argument. All that was to change for the worse.

One reason for that deterioration was that, whatever Whitlam's own personal attributes, the team he brought into government (with a small number of honourable exceptions) was sadly lacking in either abilities or personal character. Think Jim Cairns, Lionel Murphy, Al Grassby.

The dangers inherent in that were greatly enhanced by a new phenomenon – numerous ministerial private advisers exercising considerable power without any responsibility. Foremost among these ambitious opportunists was Peter Wilenski. Others included Jim Spigelman (subsequently chief justice of the NSW Supreme Court and now



chairman of the ABC), John Bannon (later Labor premier of South Australia), and several journalists, notably Brian Toohey, now a columnist with this paper, and a subsequent editor of this newspaper, the late PP ("Paddy") McGuinness.

Labor's 23-year absence from office also meant it had almost no experience of working with those who were now its public servants. Indeed, it harboured grave suspicions about them and was determined to "put them in their place" – an attitude strongly reinforced by those aforementioned private advisers. All this rapidly worked to erode that trust between ministers and their official advisers on which a Westminster system of government (as ours then still was) is founded.

No comprehensive account of the Whitlam government's economic record is possible here, but some figures may help.

Superficially, the economy continued growing. Between 1972-73 and 1975-76, non-farm GDP at constant prices grew by 8.1 per cent. However, these national accounting figures conceal more than they reveal. For example, between 1973-74 and 1974-75 private investment in dwellings plunged 22.5 per cent; new dwelling commencements crashed by 34.0 per cent in 1974-75.

Private investment in non-dwelling construction, where the "lags" are longer, fell in 1974-75 (8.6 per cent), 1975-76 (1.5 per cent) and 1976-77 (12.4 per cent). Only private investment in machinery and equipment (as employers desperately sought to cut skyrocketing labour costs) remained modestly positive, although falling 3.8 per cent in the annus horribilis 1974-75.

The first reason for these alarming developments was the government's wages policy. Under labour minister Clyde Cameron, the Commonwealth Conciliation and Arbitration Commission was pressured to raise award wage rates sharply.

Some feel for the policy madness was given in a treasury note for file on March 14, 1973. Fred Argy, then a division head in Cameron's department (and wholly sympathetic to Labor) told Cole the national wage case submission, supporting the Australian Council of Trade Unions' ambit claims and largely redrafted by McGuinness, had been further considered and "some sanity restored". McGuinness, Argy said, "was a real wild man". "His draft said that there was 'scope for a substantial redistribution from profits to wages and salaries'."

Facilitated by such chaotic policy formation, minimum weekly award rates for adult males jumped 18.2 per cent in 1973-74 and 30.5 per cent in 1974-75. Even in 1975-76, when Cameron's replacement Senator James McClelland brought a more hard-headed approach, they still rose 14.9 per cent. Female award rates rose even faster. But as Crean was to say publicly shortly before his late-1974 replacement by Jim Cairns, "one man's wage increase is

another man's job". There was also the quickly growing conviction that the Whitlam government was incorrigibly hostile to business generally. The minister for minerals and energy Rex Connor notoriously described Australian mining industry executives as "hillbillies".

The 25 per cent across-the-board tariff cut of July 18, 1973, while not without intrinsic merit, delivered a massive blow to manufacturers' confidence and set back the cause of tariff reform by almost 20 years (see my article in *The Australian* of July 18, 2003).

More fundamentally, business saw that headlong public sector expansion could only be had by squeezing the private sector commensurately. Federal authority outlays, at 24.1 per cent of GDP in 1972-73, jumped by 1975-76 to 30.5 per cent of GDP. Of all the Whitlam years' statistics, none is more crucial to our understanding of the huge shock to the economy.

This 26 per cent rise in the proportional economic significance of the federal government carried obvious consequences. The spending increases involved could be financed by either higher taxes, borrowing, or both. Income tax paid by the household sector rose explosively: in 1973-74 by 34.3 per cent; in 1974-75 by a further 40.5 per cent; and in 1975-76 by another 19.5 per cent – a total rise of 125 per cent over three years. Yet despite this massive tax increase, the Commonwealth Budget deficit, already 1.6 per cent of GDP in 1972-73 because of the outgoing government's pump-priming, climbed to 4.9 per cent of GDP by 1975-76.

Those expanding federal budget deficits had consequential implications for monetary expansion. Between the end of 1972 and end of 1975, M1 (base money) rose by 42 per cent; M3 (the most widely used index of money supply) rose by 49 per cent.

As Milton Friedman had pointed out, inflation "is always and everywhere a monetary phenomenon"; not surprisingly, therefore, inflation accelerated. In 1973-74 the consumer price index jumped 13.1 per cent; in 1974-75 by 16.7 per cent; and in 1975-76 by 12.8 per cent – some 49 per cent in three years. The non-farm GDP deflator showed even larger increases.

Interest rates, naturally, soared: certificates of deposit yields almost trebled, to 17.2 per cent by June, 1974, with 90-day bank bills then yielding 18.8 per cent. Confidence evaporated, the All Ordinaries share index tumbling 39 per cent between June 1972 and June 1975.

Even before they read of the Khemlani loans affair scandal, Australians (and foreigners) generally had come to see the whole style of government as one of utter confusion. Indeed it was. For example, a September 14, 1973 treasury note for file records a meeting between Whitlam, Crean, the minister for social security Bill Hayden, the min-



Top left, Rex Connor, minister for minerals and energy, faces questions. Top, from left, Rex Connor, Clyde Cameron, Jim Cairns, Gough Whitlam and Lionel Murphy at a ministerial meeting; Tirath Khemlani with journalist Brian Buckley; John Stone. PHOTOS: FAIRFAX ARCHIVES

ister for transport Charlie Jones, Spigelman and Sir Peter Abeles (then chairman of the major transport company TNT). ACTU president Bob Hawke and Wheeler were also present. The meeting derived from an Abeles proposal for government assistance in facilitating, and in large part financing, a TNT takeover of (initially) the UK-domiciled Shaw Savill shipping line. A week later this was ramped up to taking over Furness Withy, a much larger UK-domiciled shipping company of which Shaw Savill was a component.

In Treasury, Crean and Hayden shared strong doubts about this proposal. Jones, after originally agreeing with them, changed position after Hawke (a long-standing friend of Abeles) lent his support. For six months the paperwork mounted, with Whitlam clearly supportive and ever more bizarre possibilities canvassed by Spigelman and Wilenski.

Only the May 1974 election put an end to a matter of such politically explosive potential. (Incidentally, thanks to the loyalty of those despised public servants, this incident, apart from a brief reference in Hayden's autobiography, has gone publicly unremarked).

To sum up, the Whitlam government inherited an economy in which unemployment (then measured by persons registered for employment with the Commonwealth Employment Service) was declining, to

1.8 per cent of the labour force in August, 1973. Two years later it had more than doubled (4.6 per cent).

But the truly serious figures were those for employment. Over the three years to August, 1976 full-time jobs actually fell by 56,000 (1.1 per cent). The small rise in total employment during that time was more than wholly due to a jump of 171,000 (24.8 per cent) in part-time employment. Thus, total hours being worked in the economy actually fell 1.8 per cent from three years earlier. Meanwhile, the average duration of unemployment had almost doubled, from 9.3 weeks in August, 1973 to 17.5 weeks in August, 1976.

Looking back over those three years, I identify the "point of no return" as immediately after the May 18, 1974 election. Four days later, Whitlam convened a dinner meeting at the Lodge with Crean, deputy governor of the Reserve Bank Wheeler and me. My note for file records Crean indicating "shock therapy" was under consideration, adding, "after his discussion that afternoon with the Treasury/Reserve Bank team, he at any rate had certainly been shocked". It was agreed to set in train "the Kirribilli House process", with a meeting there two days later.

The Treasury paper of May 24 prepared for consideration that day began: "The economic outlook is very bad. The economy is in the grip of a severe, deep-seated and self-perpetuating inflation and, unless something effective is done about it, the situation is likely to worsen progressively as the year wears on. Moreover, the longer action is delayed, the harder it becomes to deal with the situation effectively".

Many further (and further expanded) meetings followed, but this initiative to tackle inflation, well motivated by Whitlam personally at the outset, ran steadily into the sands of his colleagues' growing objections. When the matter finally came to cabinet on July 22, Whitlam found himself almost totally deserted – even by Hayden. From that point on, the downhill career of the economy accelerated.

Opinions may differ on such matters as the Whitlam government's social policies or its constitutional policies, both of which I happen to think were as damaging as its economic policies. However, there are no reasonable grounds for difference on the latter, which produced the most disastrous effects on our economy of any government in our history up until that time.

In 1975 the stress applied by Labor to the economy inexorably lead to defeat at the federal election on December 13, effectively bringing the political career of Gough Whitlam to an end.

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