Australian Government
The Treasury

Economic Roundup

2009

Issue 4, 2009

Economic
Roundup

Issue 4, 2009

ISBN 978-0-642-74568-2

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Printed by Canprint Communications Pty Limited

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New paradigms to measure progress

Dr David Gruen and Joann Wilkie[1]

The concept of social progress has been with us for thousands of years, from the earliest human civilisations. For modern societies, progress is often about improving wellbeing. A wellbeing framework is at the core of the Australian Treasury's organisational identity and culture. Improving the wellbeing of the Australian people is central to the Treasury's mission statement.

The Commission on the Measurement of Economic Performance and Social Progress has admirably achieved its goals of looking at the limits of GDP as a measure of progress, identifying the elements that are more relevant to the measurement of progress and assessing the feasibility of alternative measurement methodologies. The Commission's report also makes recommendations for improving the measurement of progress that will hopefully shift us to new measurement paradigms.

Improving the measures of progress is a commendable, but complex task. A shift to new paradigms to measure progress will also require a shift to new paradigms for considering and using such measures. As the Commission states, 'what we measure affects what we do'. It affects judgements about the current state of affairs and what policy responses are needed. If we develop new measures we need to ensure we use them appropriately.

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1 The authors are from Macroeconomic Group, the Australian Treasury. This article is based on a presentation by Dr David Gruen to the 3rd OECD World Forum on Statistics, Knowledge and Policy, Busan, on 28 October 2009. It has benefited from comments and suggestions provided by Angelia Grant. The views in this article are those of the authors and not necessarily those of the Australian Treasury.

Introduction

Thank you, Enrico Giovannini for that kind introduction. And thank you, Professor Stiglitz for your stimulating presentation on the work of the Commission on the Measurement of Economic Performance and Social Progress (2009).[2]

In the time I have today, I would like to focus on three issues that need to be considered if we are to shift to new paradigms to measure progress. I will start by talking about different perspectives on progress. Then I will briefly review some of the recommendations from the Report by the Commission. Finally, and perhaps most importantly, I will address an issue I believe is of primary importance if we are to successfully shift to new paradigms to measure progress. To do so successfully, we will also need a renewed willingness to take these new measures seriously, and to use them to guide policy.

Defining wellbeing

As an economist and an adviser on government policy, I have a deep-seated professional interest in social progress. Progress is often about improving wellbeing. Progress and wellbeing mean different things to different people and organisations. Today, I will tell you a little about the perspective taken by the Australian Treasury.

Improving the wellbeing of the Australian people is central to the Australian Treasury's mission statement. We developed the wellbeing framework in the early 2000s to provide a consistent and robust understanding of wellbeing (Henry 2004; Henry 2006). The framework now sits at the core of the Australian Treasury's organisational identity and culture.

Reflecting our economic heritage, Australian Treasury's wellbeing framework adopts a generalised-utilitarian approach. Thus, in addition to income and consumption, a policy relevant assessment of wellbeing, both at the individual and social level, can in principle depend on health, education, social connectedness, crime rates, air and water quality, biodiversity, and a myriad of other aspects of life experience that people have reason to value.

The Australian Treasury's wellbeing framework has five dimensions (Box 1). They are:

- the level of freedom and opportunity that people enjoy;
- the aggregate level of consumption possibilities;

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2 Papers and presentations from the 3rd OECD World Forum on Statistics, Knowledge and Policy are available at www.oecdworldforum2009.org.

- the distribution of consumption possibilities;
- the level of risk that people are required to bear; and
- the level of complexity that people are required to deal with.

GDP is an important element of our framework because it provides an indication of the aggregate level of consumption possibilities that society is able to enjoy (although, as the Commission's report makes clear, it is an imperfect measure of consumption possibilities).

The dimension of wellbeing that stands at the heart of Treasury's framework is freedom and opportunity. Treasury's perspective on freedom and opportunity has been influenced heavily by the work of Amartya Sen on the contribution that 'substantive freedoms' make to development.

According to Sen, the true measure of human development is that an individual has the capabilities necessary to lead the kind of life they value (Sen 1999). Capabilities allow an individual to fully function in society. They are not income and, while they include basic civil rights and political freedoms, they are not limited to 'rights'.

Thus, Treasury is interested in the capabilities that Australians have to lead lives that they value. This is similar to the perspective the Commission takes on quality of life. The Report says that 'what really matters are the capabilities of people, that is, the extent of their opportunity set and of their freedom to choose among this set, the life they value'.

The wellbeing framework also reinforces Treasury's strongly held conviction that trade-offs matter deeply. Most policy reforms involve trade-offs within or between dimensions of wellbeing. These trade-offs can be complex and multidimensional. Decisions regarding policies involving such trade-offs require judgements to be made which value different aspects of social welfare. Ultimately, these decisions are rightly made by the political process — that is, in Australia's system of government, by the Parliament.

Box 1: The Australian Treasury's wellbeing framework

Freedom and opportunity

Freedom and opportunity refers to the capabilities that Australians have to lead lives that they have reason to value. Capabilities allow an individual to fully function in society. Sen (1983) identifies some basic capabilities: 'to meet nutritional requirements, to escape avoidable disease, to be sheltered, to be clothed, to be able to travel, and to be educated'. Other capabilities, such as the capability to live without shame or to participate in the activities of the community, are relative to community standards. Thirty years ago being computer literate was not necessary to participate fully in society, but it is now. In a developed country like Australia, enhancing people's capabilities requires going beyond merely avoiding basic deprivations.

Consumption possibilities

The level of consumption possibilities refers to society's command over resources to obtain goods and services to satisfy the needs and wants of its members. This concept should be considered in its broadest sense. It encompasses traditional economic concepts of income as well as less tangible concepts such as the application of political authority. It includes market and non-market goods and services, both material and intangible. It sees value in voluntary work, personal and professional relationships, the quality of the physical environment, education, and health and leisure.

Distribution

Distribution has spatial and temporal dimensions. It refers to the spread of all aspects of consumption possibilities across the population, including across different societal groups, geographic regions and generations.

Risk

Risk refers to the intrinsic uncertainty in possible outcomes that is present in almost all decisions (Banerjee and Ewing 2004). In this broadest conceptual sense, risk impacts on all individuals, and is everywhere in the economy and society. People have different preferences toward risk. All else being equal, it would be expected that wellbeing would be improved if there is a better match between risk preferences and risk borne. Achieving this is complicated by the fact that contexts, paths and perceptions matter (Kahneman 2003).

Complexity

Complexity refers to the number of considerations, and the interconnections between those considerations, that are relevant to many economic and broader social decisions. Complexity is sometimes imposed by governments (for example, the tax code) seeking to respond to a range of stakeholders in the community with disparate interests.

The Treasury wellbeing framework is one approach to thinking about wellbeing and social progress. Other approaches, such as those taken by the Commission, the OECD's Global Project and the Australian Bureau of Statistics, which reflect their organisations' perspectives and purposes, also have much value (ABS 2001; ABS 2009 and

Giovannini et al. 2009). Indeed, given the broad scope of the wellbeing concept, it is often useful to consider a number of approaches to wellbeing.

Measuring wellbeing

Conceptualising and measuring wellbeing are distinct endeavours. Treasury's wellbeing framework, for example, is qualitative. On the other hand, the Australian Bureau of Statistics' publication *Measuring Australia's Progress* (ABS 2009) provides both a conceptual framework, as well as indicators to measure progress.

The broad range of perspectives that people and organisations bring to wellbeing and progress means that there is a need for a similarly broad range of measurements and indicators that can be usefully employed to assess wellbeing and progress.

The Report by the Commission on the Measurement of Economic Performance and Social Progress (2009) makes a remarkable contribution to the continuing debate and discussion about how best to measure wellbeing and progress. It has admirably achieved its goals of looking at the limits of GDP as a measure of progress, identifying the elements that are more relevant to the measurement of progress and assessing the feasibility of alternative measurement methodologies.

The Report will be an important input to discussions and debate at the international and national level through forums such as these, the OECD's Global Project more broadly, and the endeavours of national statistical agencies.

While many of the measurement issues have been canvassed before, the Report speaks with an authority that arises from the eminence of those on the Commission, and it provides constructive ideas for how producers of statistics can improve the measurement of wellbeing.

I do not want to spend a lot of time reviewing the Report and its recommendations, but I would like to highlight a few of its key messages.

The context for measuring wellbeing and progress

Perhaps one of the crucial messages of the Report is its emphasis on the importance of improving the measurement of progress.

What we measure affects what we do. Statistical indicators affect judgements about the current state of affairs, trade-offs between the dimensions of wellbeing, appropriate policy responses, what societies and individuals value and their goals.

The Report also highlights the need for a statistically literate society. Statistics are a feature of modern life and users of statistics need to be aware of: the measures that are available; their strengths and weaknesses; and how to use them appropriately.

Improving measurements

The Report makes a number of specific recommendations to improve how we measure progress. Again, instead of going into detail, I would just like to note a few key points.

As the Report acknowledges, we have long been aware of the limitations of GDP as a measure of economic performance and wellbeing (for example, Australian Treasury 1964 and Australian Treasury 1973). We need to improve how we measure economic activity and economic performance, especially as it relates to quality and non-market services.

We also need to improve how we measure wellbeing. For some aspects of wellbeing, like material living standards, we have reasonably good measures. For others, like health and education, we have proxy measures. These are serviceable, but we could improve on them. For yet other aspects, like political voice or social connectedness, there are few measures available and we need to develop more.

Perhaps one of the most novel and welcome aspects of the Report from my perspective is its discussion of sustainability. Sustainability is an issue that to date has tended to be looked at in isolation from other issues. For example, there are often separate processes for considering long-term fiscal sustainability (in reports produced by Treasuries or Finance Departments) and the sustainability of the environment in discussions of climate change. But, as the Commission points out, the sustainability of social progress needs to take into account all of the dimensions of sustainability.

Of particular importance is the Report's emphasis on considering wellbeing and sustainability separately. The two concepts are closely intertwined, not least because wellbeing may be affected by intergenerational considerations; for example, whether our children will be able to enjoy the same environmental biodiversity that we do.

The key focus of sustainability is on a comparison between the present and the future. Sustainability requires that at least the current level of wellbeing be maintained for future generations. It requires the simultaneous preservation or increase in several stocks, such as the quantities and qualities of renewable natural resources, human capital, social capital and physical capital. Perhaps some of our greatest measurement challenges are in this area.

Putting it into practice

Improving the measures of progress is a commendable, but complex task. A shift to new paradigms to measure progress will also require a new willingness to take the new measures seriously, and to use them to inform policy choices.

We already have some measures of wellbeing and sustainability, and we are looking to develop others. But little will change if those making the decisions that affect peoples' lives — governments, communities and individuals — are not willing and able to look beyond economic performance and consider how their decisions affect wellbeing and progress.

This is why it is important for public policy institutions to have a framework that includes a role for wellbeing and sustainability. We at the Australian Treasury have found it valuable to have such a framework — because it encourages a broader analysis of the impacts of policy that goes beyond a focus on GDP and material considerations (Henry 2004 and Henry 2006). Given our favourable experience, I would encourage others to introduce such a framework as an organising principle into their organisations.

To achieve a simultaneous shift in measurement and the use of measures, we will have to acknowledge that all measures have their limitations. We will need to use both qualitative and quantitative data. And we will need a range of indicators. Summary indexes can be useful, but they cannot provide the full spectrum of information on progress that we need.

In reflecting on the current global financial crisis, the Commission is surely right that 'better measures may enable us to steer our economies better through and out of crises'. But better measures alone will not be sufficient. We must be willing and able to use them.

On this point, it is instructive to reflect upon the failure of economists to warn of the increasing fragility of the global financial system in the years leading up to the current crisis.

Economists have the tools and skills that would have enabled them to issue such warnings but, with a few notable exceptions, they did not do so. Why? In part, the answer has to do with the discipline's general focus on, and interest in, models in which financial markets are efficient and well functioning, and market participants know what they are doing.

This has meant that we have paid too little attention to real-world phenomena like long-lived asset price bubbles, or herd-like behaviour in financial markets. Of course, some economists have studied these phenomena, but they are not yet part of the mainstream economic consensus.

The tools economists have at their disposal, such as including behavioural features in their models, may not be perfectly suited to examining the possibility and impacts of such phenomena. But they do exist and it may be possible to develop more. The key point is that economists must be willing and able to use these tools.

The same is true of measuring progress. Yes, we need to improve on the measures we have, and we must develop new measures. But, if we are to use these measures to steer our societies through crises, then we must learn to use these measures appropriately, taking into account their limitations, using qualitative data when quantitative data are not available, considering behavioural influences, adjusting for possible shifts over time, and using a wide range of indicators to get a better understanding of what is happening in our societies.

Conclusion

Improving how we measure wellbeing is important for gauging economic performance, social progress and sustainability. It is also of vital importance for policy. Shifting to a new paradigm for measuring progress is a big and complex task. If we are to be successful in this endeavour, the development of this new paradigm will need to be accompanied by a renewed willingness to take these new measures seriously, and to use them to guide policy.

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Fiscal policy: more than just a national budget

Dr Ken Henry AC

Address to the 2009 Whitlam Institute Symposium, 30 November 2009

Introduction

Good morning.

It is a pleasure to be with you today at this Whitlam Institute Symposium.

My topic is 'Fiscal policy: more than just a national budget.'

This topic is equally interesting put the other way around: 'The national budget: more than just fiscal policy.' Today, I want to say something about both topics.

The term fiscal policy is usually associated with the use of the budget as a macroeconomic tool for the management of aggregate demand in the economy.

The work of Keynes and other pioneers of macroeconomics through to the 1950s, given impetus from the Great Depression, generated, and sustained, interest in the budget being used in this way.

Then, from the 1970s, other theoretical advances in economics — notably through the work of people like Robert Barro — encouraged policy makers to understand the limitations of fiscal policy as a macroeconomic tool.

In more recent times, an improved understanding of the operation of monetary policy, and the establishment of stronger monetary institutions, have seen monetary policy become the preeminent tool of short-term demand management.

Over time, fiscal policy considerations have come to have more to do with the quality of government spending and taxation policy interventions in the economy.

In Australia's case, this essentially microeconomic perspective on fiscal policy has probably been encouraged by the adoption of a medium-term fiscal strategy, of balance on average over the cycle, and — more particularly — by the targeting of a small surplus for several years in this decade during which the stance of monetary policy was adjusted quite considerably.

And the perspective was probably made even sharper by the debate, stimulated by a couple of intergenerational reports, about the long-run sustainability of fiscal policy settings.

And then along came the global financial crisis.

Today, in late 2009 one would have to conclude that our understanding of fiscal policy has to be quite sophisticated.

The nature of spending is always important. And monetary policy remains the primary tool of demand management.

But the results of our response to the global financial crisis, and that of other countries, demonstrates that fiscal policy can, indeed should, in sufficiently challenging circumstances, be used to complement monetary policy to achieve better macroeconomic outcomes.

I am not just referring to providing stimulus to the economy through government spending either. Most of the actions taken by governments around the world in providing guarantees in support of domestic financial systems were also fiscal policy actions — with governments positioning public sector balance sheets in support of private sector activity.

The Australian Government's discretionary fiscal policy response to the global financial crisis has been discussed extensively elsewhere. It is not my intention to cover that ground again today. Instead, I want to make the point that macroeconomic demand management is only one of the functions of fiscal policy — albeit, at times, a rather important one.

A broader understanding of fiscal policy encompasses all of the micro-level detail in all of the revenue and expenditure decisions of government.

In 2008-09, the combined effect of the Australian Government's discretionary fiscal stimulus measures are estimated to be around $28 billion or 2½ per cent of GDP. By any measure, this is a large fiscal stimulus. Even so, it is still only around 10 per cent of the national budget. So there is a lot more going on in the national budget beyond these discretionary fiscal policy measures.

Discretionary demand management seeks to ameliorate macroeconomic fluctuations — to reduce aggregate volatility in economic growth. Beyond the very short term, it is not concerned with economic growth per se. But much of the 'micro' detail of the budget is concerned with growth. And even that which is not concerned with growth probably affects it anyway.

The impact of fiscal policy on growth is important. It is a topic of enduring interest to economists and others with an interest in public policy. And there is, as yet, no generally accepted set of conclusions to draw on. Despite that, today I want to go further.

What I want to talk about today is the way in which all of that micro detail — the choices made in a government's budget — affect not only economic growth but, more broadly, wellbeing.

Looked at from a wellbeing perspective, fiscal policy and the national budget have a broader and more important role to play than is commonly understood. In particular, fiscal policy can play an important role in building human capabilities.

Fiscal policy and Treasury's wellbeing framework

Treasury's advice on fiscal policy — as in all other policy areas — is informed by the wellbeing framework that sits at the core of our mission statement. This framework was developed in the early part of this decade to provide a consistent and robust architecture to guide our policy advice.[1]

The Treasury wellbeing framework has five dimensions:

- centrally, the level of freedom and opportunity that people enjoy;
- second, the aggregate level of consumption possibilities;
- third, the distribution of consumption possibilities;
- fourth, the level of risk that people are required to bear; and
- fifth, the level of complexity that people are required to deal with.

Treasury's perspective on freedom and opportunity has been heavily influenced by the work of Amartya Sen on the contribution that 'substantive freedoms' make to development.

According to Amartya Sen, the true measure of human development is the capabilities that an individual has to choose a life they have reason to value.[2] Capabilities allow an individual to fully function in society. They are not income and, while they include basic civil rights and political freedoms, they are not limited to 'rights'.

In applying this framework to fiscal policy we have to consider not only the relevance of fiscal sustainability to questions of intergenerational equity, but, more broadly, the impact on the wellbeing of individuals, and society as a whole, of every one of the expenditure and revenue decisions of government.

This is no small task.

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1 See, for example, Henry, K 2004, 'Policy Advice and Treasury's wellbeing framework', Economic Roundup, Winter, Treasury, Canberra, available at: http://www.treasury.gov.au/documents/876/PDF/Policy_advice_Treasury_wellbeing_framework.pdf.

2 Sen, A 1999, Development as Freedom, Oxford University Press, Oxford.

Wellbeing and the size of government

What about the size of government?

The Whitlam Government came to power with a broad ranging policy agenda — the implementation of which had the effect of increasing both the scope and size of Australian Government. The agenda included real increases in social welfare payments,[3] free university education, universal medical coverage, new departments of Aboriginal Affairs, Environment and Urban and Regional Development, and significant public sector real wage rises.

The policy initiatives were reflected in strong growth in the level of government outlays over the course of the Whitlam Government.

Australian Government expenditure grew from 18.9 per cent of GDP in 1971-72, the last full budget year before the Whitlam Government came to power, to 24.8 per cent of GDP in 1975-76, the last budget delivered by the Whitlam Government, representing spending growth of around 56 per cent in real terms.

In the three and a half decades since, while there have been significant annual fluctuations, the average level of spending by the Australian Government has changed little, to be around 25¼ per cent of GDP.[4]

The Whitlam Government was, therefore, responsible for an enduring increase in the size of government. That is, the close to 6 percentage points of GDP expansion in government expenditure during the Whitlam Government has never been reversed. And I think I can safely say that it never will be.

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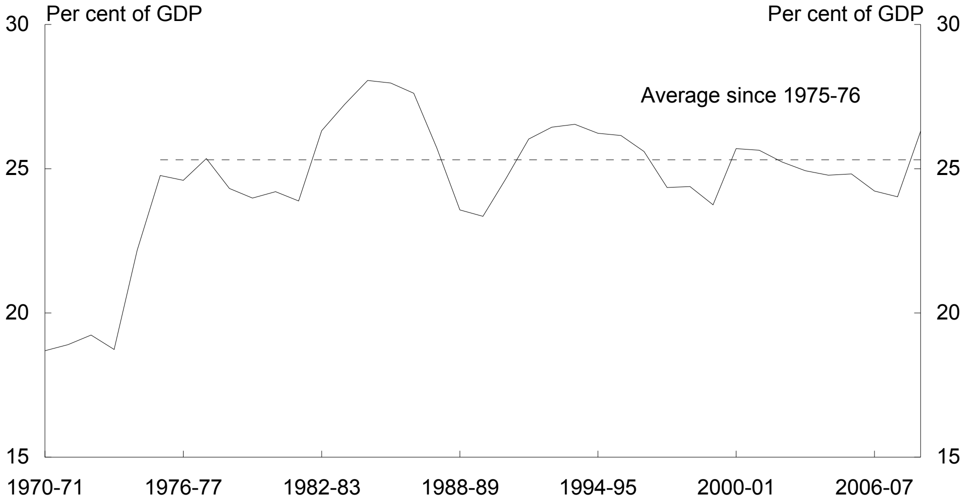
3 Unemployment benefits to individuals more than doubled in real terms; widows pension expanded to supporting mothers; disability pensions expanded.

4 It is necessary to qualify this statement by noting that there a number of structural breaks in historical budget information due to changes in accounting classifications that cannot be eliminated by backcasting data. See Appendix D of the *Mid-Year Economic and Fiscal Outlook 2009-10*, for further information.

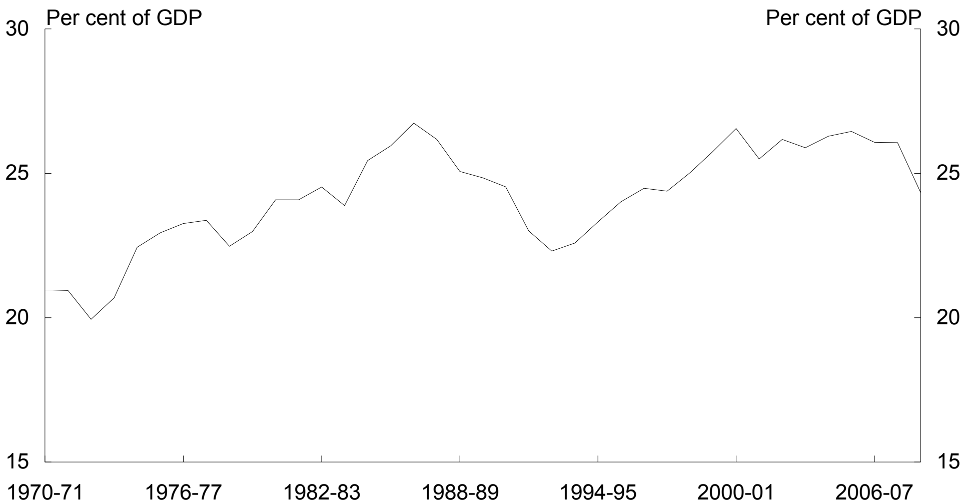
Chart 1: Government expenditure as share of GDP



Source: *Mid-Year Economic and Fiscal Outlook 2009-10*.

Initially, the increase in government expenditure was not matched by a commensurate increase in government revenue, with revenue increasing by only two percentage points of GDP over the term of the Whitlam Government (from 20.9 per cent of GDP in 1971-72 to 22.9 per cent of GDP in 1975-76). Subsequent governments chose to fund the increased expenditure through increased taxation rather than ever growing levels of public debt; that is, to make larger government fiscally sustainable.

Chart 2: Government receipts as a share of GDP



Source: *Mid-Year Economic and Fiscal Outlook 2009-10*.

What are the implications for wellbeing of these aggregate developments?

Whatever the size of government, fiscal sustainability is important for maintaining macroeconomic stability, reducing aggregate economic vulnerabilities; and, in those ways, improving aggregate economic performance. It reduces the degree of uncertainty about future policy settings and facilitates growth-enhancing economic decision-making, especially regarding the accumulation of physical and human capital.

Fiscal sustainability is likely, therefore, to be of positive value to aggregate measures of wellbeing, both now and in the future.

The impact of the size of government on wellbeing is less clear.

Based on the numerous efforts to estimate, for developed countries, an empirical relationship between size of government and aggregate measures of things relevant to wellbeing, including rates of economic growth, it would be sensible to conclude that the optimal size of government is not a question that can be answered by a technical economic analysis.

The question that is of key concern to the Treasury, then, goes beyond aggregates, to consider the impact on wellbeing of changes in the micro-level detail of government expenditure and revenue.

I have noted that the wellbeing framework comprises five dimensions. It would be an exceptional case in which a policy intervention would be considered unambiguously positive across all five dimensions. Indeed, the wellbeing framework reflects our conviction that trade-offs matter deeply, emphasising the importance of assessing policy interventions in broad terms.

The role of fiscal policy in building capabilities

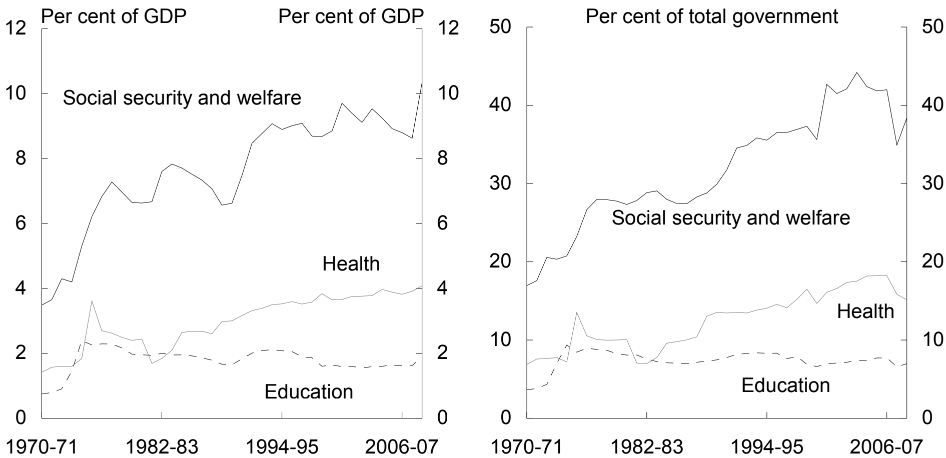
An analysis of some of the key components of the increase in government expenditure since 1971-72 illustrates some of the trade-offs involved.

Overall, in 1971-72, Australian Government expenditure on health, education, and social security and welfare was around 6 per cent of GDP, or around 29 per cent of total outlays. By 1975-76, this had doubled to 12 per cent of GDP, or around 45 per cent of all outlays.

That is, the total increase in government expenditure under the Whitlam Government is fully explained by an expansion of the social policy role of government in health, education and social security and welfare.

And the trend established by the Whitlam Government has persisted. By 2008-09, the proportion of the Australian Government's budget allocated to social security and welfare, health and education had grown from 45 per cent to more than 60 per cent, equal to an increase from 12 per cent of GDP to 16¼ per cent of GDP.

Chart 3: Health, education and welfare expenditure as a share of GDP and total Government expenditure



Source: Treasury calculations.

What do we have to show for these increases?

In attempting to answer this question I will focus separately on social security and welfare, and health expenditure. Unlike education, in both of these areas, strong growth in outlays has continued post-Whitlam.

Social Security and Welfare expenditure

In 1971-72, Australian Government expenditure on Social Security and Welfare was around 3¾ per cent of GDP or around 17½ per cent of total outlays. By 1975-76, this had risen to 6¼ per cent of GDP or around 23¼ per cent of outlays.

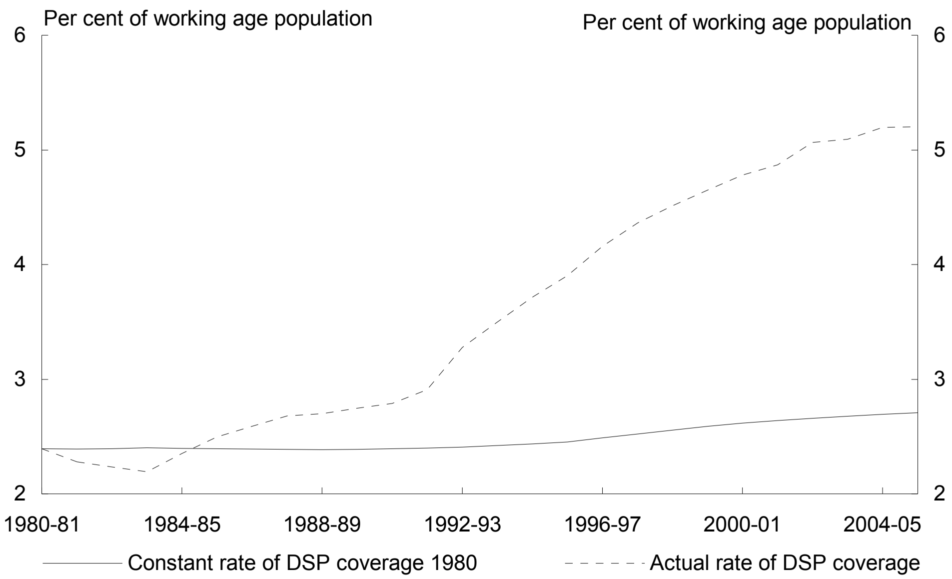
Since then, Social Security and Welfare spending has continued to rise, to be around 10½ per cent of GDP and 38½ per cent of the *2008-09 Budget*.

Initially, an increase in the real level of welfare payment rates was an important factor in this rise.[5] However, over time, welfare expenditure has been driven by an increase in the number of recipients.

In part, the increase in income support recipients reflects demographic factors that are effectively 'locked in'. As the population ages, there are more age pension recipients. Age pension outlays have increased from 1.6 per cent of GDP in 1971-72 to be around 2½ per cent of GDP in 2006-07. The most recent IGR (2007) projected age pension outlays to increase by a further 1.9 per cent of GDP over the forty years to 2046-47.

Population ageing can also affect other income support payments. In particular, the level of disability support payments among older workers is significantly higher (Chart 4).

Chart 4: Disability Support Pension customers: Historical and with the DSP coverage rate held constant (at 1980)



Source: Treasury calculations.

But this is not the main factor behind the increase in welfare spending in recent decades. The proportion of income support recipients that are age pension recipients has actually fallen from around 75 per cent in 1971-72 to around 50 per cent today.

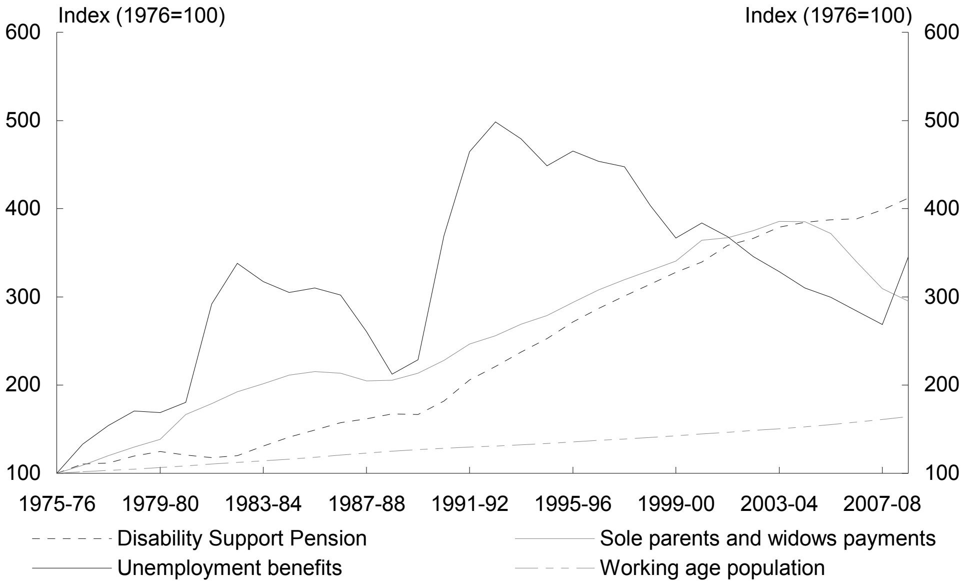
Of course social security and welfare payments can be affected by economic conditions as well as policy decisions — as unemployment rises so do outlays on unemployment

5 Unemployment benefits increased by around 24 per cent in real terms between the June quarter 1973 and the September quarter 1974.

payments. The 1970s saw unemployment increase substantially, reflecting increased numbers out of work and for longer durations. But the increase in the unemployment rate is not the main contributor to the increase in the number of income support recipients.

The main contributors are sole parents and the disabled. Indeed, for many years now, there have been more people receiving disability support pensions than unemployment benefits.

Chart 5: Growth in selected income support payments



Source: DEEWR and Treasury estimates

While much has been said and written on these matters, the fact is that we do not have a wholly satisfactory explanation for all of this growth in income support recipients.

Even so, it is understandable that economic and social policy analysts would be enquiring about the extent to which the tax and transfer system might be affecting people's decisions about the kind of life they lead; whether the tax and transfer system is making it more or less likely that they are choosing a kind of life that they have reason to value.

While there are many factors that affect workforce participation, where a decision is made not to work due to financial disincentives imposed by the tax and transfer system, then that, along with the longer-term capability costs of the decision not to work, should be of great concern.

If the policy settings are not right, if incentives are misaligned, the tax and transfer system can deprive individuals of the opportunity to develop their capabilities; perversely, it can lock disadvantaged groups into cycles of dependence.

The tax review that I have been leading these past 18 months has been told many times, including by those who are themselves disabled, that the current system does not adequately recognise the desirability of some people with a disability participating in work, with their income support payment effectively contingent on them working little or not at all.

That is one perspective. Understandably, however, not everybody sees adverse incentives as the problem.

But, whether it is because of poor incentives in the tax and transfer system or something else entirely, it is hard to believe that an ever increasing number of people dependent on income support is the best we can do.

Thus, despite the difficulty of the task, reducing the distortions to participation and finding other ways of enhancing the opportunities for individuals to build the capabilities to lead the kind of life they value, and have reason to value, must remain an important goal of policy. And the budget provides the instruments for pursuing that goal.

Health

Another way that the budget can improve human capability is through health expenditure. In 1971-72, Australian Government expenditure on health was around 1½ per cent of GDP or around 7 per cent of total outlays. By 1975-76, this had risen to 3½ per cent of GDP or around 13½ per cent of all outlays.

While health expenditure then fell to a little under 2 per cent of GDP in 1982-83, it has increased steadily since to be above 4 per cent of GDP in 2008-09.

There are several factors behind this increase in public health expenditure.

Most obviously, health spending tends to rise as the population ages. We tend to need more health services as we get older.

In addition, technological developments means that the range and quality of health services available increases over time.

And income growth encourages a more than proportionate increase in the demand for health services.

The most recent (2007) Intergenerational Report projected that Australian Government health spending would grow to 7.3 per cent of GDP in 2046-47. Updated projections will be presented in the next Intergenerational Report, to be released prior to the 2010-11 Budget.

Clearly, health expenditure will be a significant source of fiscal pressure in coming decades.

Meeting the community's demands for more and better quality health services within a restricted fiscal envelope will be increasingly challenging for governments.

It will require difficult choices — trade-offs — to be made; about the level and quality of health services we consume, who pays for them, and how.

The need for better measurement

As the fiscal pressures of an ageing population mount, governments will be judged by their ability to deliver better quality public services within ever tighter budget constraints.

Unfortunately, the ability of the community to be able to make well-informed judgements is limited by the fact that we are well short of having sufficiently good information about the nature of governments' taxation and expenditure programs, and the relationship they bear to outcomes. There are several reasons for this.

It is often difficult to measure the quantity and quality of public sector services.

ABS[6] measures of the value of output of the health and education services sectors are based on the cost of production, with the split between quantity and price largely based on relevant wage cost indices.[7]

This means, for example, that if it takes one doctor twice as long to perform the same medical procedure to the same quality as another then the first doctor is calculated to have produced twice as much.

As the Report by the Stiglitz-Sen Commission on the Measurement of Economic Performance and Social Progress notes,

6 It is not my intention to be critical of the ABS per se — their measures are as good as any that I am aware of.

7 This is in annual supply and use tables. For quarterly publications hours worked data are used.

> An immediate consequence of [using inputs to measure these services] is that productivity change for government-provided services is ignored, because outputs are taken to move at the same rhythm as inputs. It follows that if there is positive productivity growth in the public sector, our measures under-estimate growth.

Similarly, if there is negative productivity growth in the public sector, our measures over-estimate growth. Improving the measurement of non-market service sectors of the economy is one of the Stiglitz-Sen Commission's priority recommendations.

It is also difficult to measure the outcomes in areas such as health. For example, life expectancy is the most broadly available (and therefore most commonly used) indicator of health outcomes, but it is clearly an incomplete measure of the health of the population.

Life expectancy measures mortality only. It does not provide any information on the quality of life or the burden of chronic disease. Ideally, we want an indicator that includes information on both mortality and morbidity. However, as noted by the Stiglitz-Sen Commission,

> Although several combined indices of people's health exist, none currently commands universal agreement. Further, they all inevitably rest on ethical judgements that are controversial, and on weights for various medical conditions whose legitimacy is not always clear.

Even if we could solve these dilemmas we would still be left with a third: the difficulty in identifying the impact of changes in government expenditure on outcomes that are also heavily influenced by individual decisions and behaviours.

The lack of evidence of a clear relationship between increased expenditure and better outcomes is not to say that more expenditure will not improve outcomes. Yet it is probably safe to say that micro-level decisions on where, and on what, we spend money are just as important. It is also clear that good program design and delivery are important to getting value for the public's money.

Fiscal policy, risk and structural adjustment

Finally, I would like to highlight briefly another important way in which fiscal policy, and the budget, can (and has been) used to improve wellbeing.

There is, I think, a solid consensus that economic reforms of the past quarter of a century have played an important role in the improved performance and resilience of the Australian economy.

It is less widely appreciated how the Budget has often been used as a tool to help smooth the implementation of these reforms, facilitating the often difficult adjustments that accompany structural reforms.

A recent OECD study on The Political Economy of Reform commented that:

> One of the most robust findings to emerge from recent econometric work on the political economy of structural reform is that sound public finances tend to be associated with more reform.

To put this (retrospectively) into our wellbeing framework, structural reforms have often involved increasing risk to some parts of the community in order to benefit Australian society in some aggregate sense. Other reforms that were considered desirable at an aggregate level were often considered to have undesirable distributional consequences.

In many such cases, reforms were 'purchased' by compensating 'losers' from the budget.

There is a legitimate role for using the budget in this way, with some qualifications. First, the reform should be worth the cost of the compensation involved. Second, the payments should ease rather than hinder the necessary adjustment process.

Let me give some examples.

By the early 1980s it was clear that real wages growth had outpaced productivity growth, and this was contributing to a persistently high unemployment rate. In accord with the trade union movement, the government of the day provided income tax reductions and other 'social wage' payments for the benefit of workers in return for real wage restraint. This allowed a sustained period of real wage moderation, which was an important factor behind the considerable reduction in the unemployment rate late in that decade.

Similarly, it was considered that, in the absence of appropriate compensation arrangements, the introduction of the Goods and Services Tax would have had a disproportionate adverse impact on some sectors of the community. Tax cuts and other compensation payments were used to address these distributional issues and smooth the implementation of the reforms.

An important element of the effective implementation of the National Competition Policy reforms in the 1990s was progressive National Competition payments from the Commonwealth to the States. The rationale for these payments was that while the States were primarily responsible for the implementation of NCP reforms, the benefits would be shared broadly through the national economy. The payments provided a way of distributing the benefits of reform in a manner that had political traction.

The creative and active use of the budget in the structural reform process has made an important contribution to Australia's wellbeing.

Conclusion

The Whitlam Government can be seen, in retrospect, as having been responsible for a permanent increase in the size of Australian government. There has been a lot of interest over the several decades since Whitlam in the economic consequences of larger government and the appropriate role of fiscal policy in a modern economy. Much of that interest, on both sides of some quite intense debates, has been ideological. But it would be fair to say that both the intensity and ideological content of the debates has abated over time. One reason for that is a growing interest in the microeconomics of the national budget. That growing interest is a good thing.

Currently, it is being hampered, significantly, by deficiencies in measurement; of inputs, outputs and — most importantly — outcomes. There is a need for better measurement.

From a Treasury perspective, all of the micro-level detail in the spending and taxation decisions in the national budget are relevant to the wellbeing of Australians; they should be intended to contribute to the ability of Australians to build capabilities that allow them to choose lives they have reason to value.

Reforms we implement today build capacity for governments of the future to assist Australians in this way.

Thank you.

What have we learnt? The Great Depression in Australia from the perspective of today

Dr David Gruen and Colin Clark[1]

19th Annual Colin Clark Memorial Lecture, Brisbane, 11 November 2009

1 The authors are from Macroeconomic Group, the Australian Treasury. They are grateful to Rebecca Brown, Paul Dearlove, Katrina Di Marco, Angelia Grant, Tim Hatton, Steven Kennedy and Robert Seaton for helpful contributions and comments. The views expressed are those of the authors and not necessarily those of the Australian Treasury.

Introduction

I am grateful to the University of Queensland School of Economics, the UQ Economics Alumni Association, the Queensland branch of the Economic Society of Australia and Queensland Treasury for inviting me to deliver the nineteenth Colin Clark Memorial Lecture.

My topic today is: What have we learnt? The Great Depression in Australia from the perspective of today. I am interested in particular in what lessons were learnt from the experience of the 1930s, and how these lessons have informed more recent economic policy decisions. By more recent economic policy decisions, I have in mind not only the policy responses to the current global financial crisis, but also the policy frameworks put in place in the modern era that have rendered the economy much more resilient to macroeconomic and financial shocks.

Along the way, I will do my best to enliven the narrative with reflections on Colin Clark's life, on his perspectives on the Great Depression and the policy responses to it.

The intellectual figure that towered over the Great Depression and its aftermath was, of course, John Maynard Keynes. Colin Clark's close links to Keynes are well known — as is the fact that Keynes quotes Clark in the General Theory (1936), and referred to him several years earlier as 'a bit of a genius' (Keynes 1931).

At the time of the stock market crash in October 1929, Colin Clark was a young man of 23 and just beginning his career as an economist after graduating in chemistry at Oxford the year before. There can be little doubt that his achievements in economics over his long and productive career — including his pioneering work in co–founding (with Simon Kuznets) modern national income accounting — were greatly influenced by the upheavals and hardships he witnessed during the Great Depression.

Beyond Colin Clark's professional achievements in economics and statistics, there is another aspect of his life that particularly resonates with me: his lifelong belief in the tangible improvements to people's lives that could be made through better economic policy making. This was highlighted in his decision in 1938 to reject overtures from Keynes in Cambridge, as well as the University of Chicago, to pursue a career as an academic economist in favour of working as an applied economist in the public sector in Australia.

Although I never met Colin Clark, I do have a familial link to him — I have worked with his grandson and namesake for the past couple of years at the Treasury. And I am most grateful to grandson Colin for his help preparing this speech and for the insights he has given me into his grandfather.

Grandfather Clark's sheer enthusiasm to 'practice what he preached' is palpable in a letter he wrote to Keynes in 1938 about his decision to stay in Australia. As he put it, the chance to advise the Queensland Premier on 'practically everything connected with economic matters' was 'too remarkable an opportunity to be missed for putting economics into practice' (Markwell 2000).

In the 1930s, economists in Australia (and elsewhere) did not enjoy anything like the level of influence over public policy that they do today (Coleman et al. 2006). So Colin Clark's choice was important, and it reaffirms the career choices of thousands of economics graduates in Australia over past decades who also put economics into practice in their day–to–day work in a range of public sector organisations, at both the Commonwealth and state levels.

The global context

Before turning to the Australian experience, I will spend a few minutes on comparisons between the Great Depression and the current global recession for a broad set of countries.

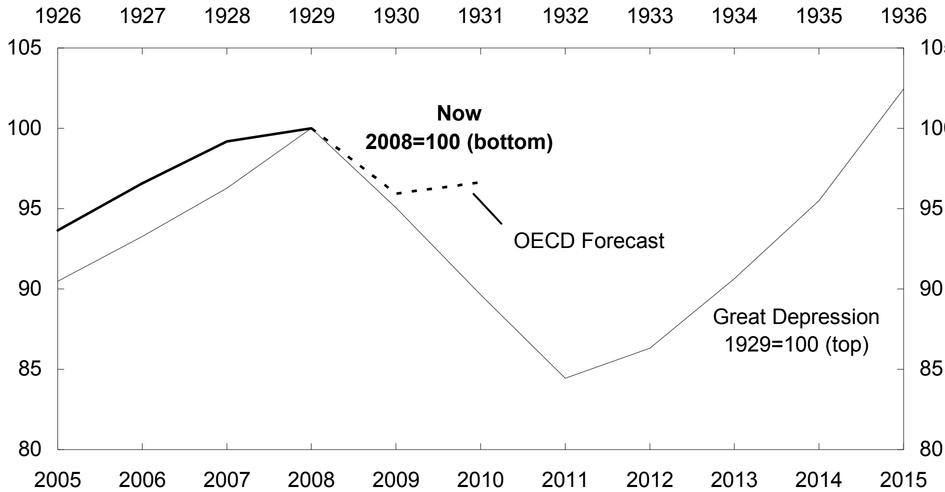
For many countries (though with some notable exceptions like the UK and Germany), the 1920s was a decade of rapid growth and rising prosperity. Asset markets had been booming fuelled by easy credit. US stock prices more than tripled in the five years leading up to October 1929. There had been rapid financial innovation and increased leverage by both financial institutions and households. They were not called the roaring twenties for nothing. The similarities with the lead–up to the current global recession are clear enough.

Although the two upswings were brought to an end by different means — by the Wall Street crash in October 1929, and by the credit crisis that began in August 2007 — the ensuing events also had some striking similarities.

Looking at GDP first, we see that real GDP in OECD countries during the first year of the current recession fell by only slightly less than in the first year of the Great Depression (an estimated 4.1 per cent rather than 4.9 per cent) (Chart 1).[2]

2 In drawing comparisons between the 1920s/30s and now, it should be remembered that there are unavoidable differences between data collected then and now. There have been profound changes in collection methodology, including definitions of unemployment, and in accounting practices, and modern measures of most types of economic activity are much more detailed than was possible 80 years ago.

Chart 1: Real GDP in OECD countries[(a)]

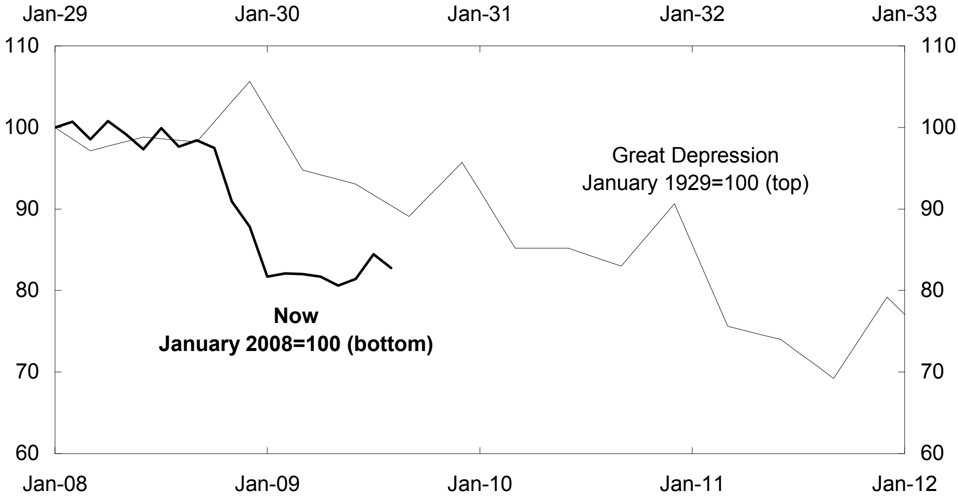


(a) OECD data for the Great Depression are estimates and exclude Czech Republic, Hungary, Luxembourg, Poland, Slovakia and Turkey.
Source: GGDC–Maddison International Historical Database (http://www.ggdc.net/Maddison/) and OECD Economic Outlook, no. 85, June 2009.

Of course, what turned a recession in the 1930s into the Great Depression was the continued collapse in economic output for the subsequent two years, before recovery took hold in 1933. By contrast, in the current global recession, we are now seeing signs of recovery in most OECD countries, and most forecasters expect this recovery to strengthen over the next year or so.

Turning to trade, large falls in world trade were a feature of both the Great Depression and the current global recession. While world trade volumes fell by 30 per cent over three years in the Great Depression, they fell much more sharply in the current recession — by almost one–fifth since early 2008 (Chart 2).

Chart 2: Volume of world trade



Source: CPB (2009) and League of Nations (1939) compiled in PC (2009).

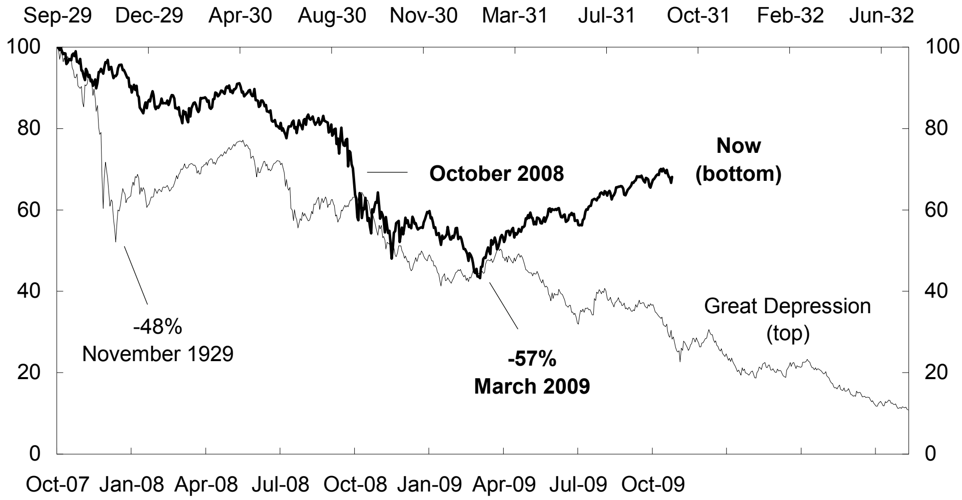
There are also broad similarities in the magnitude of the falls in the US stock market in the first 18 months of the two crises. There had been an extended period of strong growth in stock prices before both crises.[3] In October 1929, the Dow Jones industrial average fell sharply, by 48 per cent by early November 1929. Following a rally in early 1930, the market continued to fall steadily for a further two years to record a scarcely believable 90 per cent collapse from the peak (Chart 3).

During the current crisis, US stock price falls were more gradual over the first 12 months, reflecting different patterns of transmission in the two crises. The financial crisis which preceded the Great Depression began with a stock market crash and then spread to the banking system. In contrast, the current financial crisis began in the credit markets and then spread to the banking system and the stock market.

3 US stock prices (the Dow Jones Industrial Average) increased by 240 per cent in the five years leading up to the stock price peak before the Great Depression compared to a more modest 75 per cent rise (in the S&P 500) during the most recent episode. A number of other parallels between the two episodes have been noted, particularly in the US, including rapid financial innovation facilitated in part by new technologies; an extended period of loose monetary policy followed by relatively rapid tightening; relaxation of credit standards; increased leverage of financial institutions and households; increased fraud and other forms of criminal behaviour; and pervasive expectations of continued asset price appreciation combined with a widespread failure to comprehend and price risks appropriately (Eslake 2009).

Sharp falls in the S&P 500 following the collapse of Lehman Brothers meant that a year and a half from the most recent stock market peak in the US, the total decline was comparable to that of the Great Depression. By contrast, however, in the seven months since then, US share prices have recovered strongly.

Chart 3: US stock market[(a)]
(Index)



(a) Current data are S&P 500. Data for Great Depression are Dow Jones Industrial Average.
Source: Standard and Poors 2009.

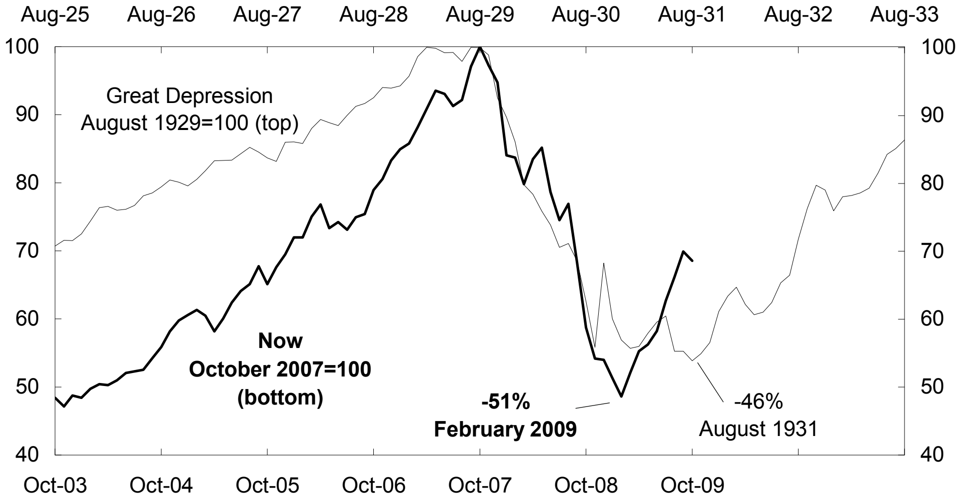
Australia

Unlike in the US, the lead up to the two episodes in Australia was quite different. In the current episode, Australia had experienced 17 years of uninterrupted growth, declining unemployment and, in the past five years, booming terms of trade. By contrast, the years leading up to the Great Depression were much less buoyant. Then, the Australian economy had experienced no real growth for five years and, as a consequence, unemployment was rising. Furthermore, as we will see, Australia was in the midst of a balance of payments crisis.

There were, however, some points of similarity. In common with the US, Australia's stock market experience was similar to that in the Great Depression, at least in its early phase.

Both crashes were preceded by periods of strong growth in stock prices. Furthermore, the falls during the current downturn are of a similar magnitude to those in the first 12 to 18 months of the Great Depression (Chart 4).

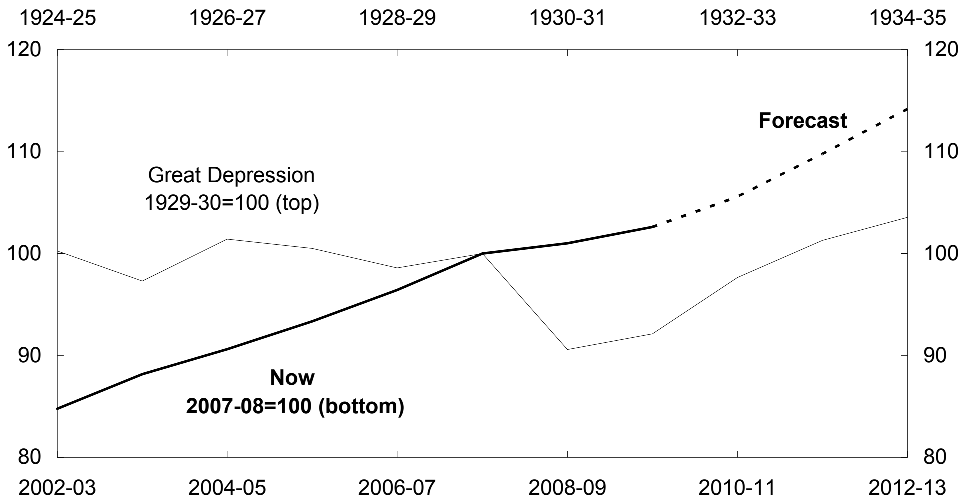
Chart 4: Australia's stock market[(a)]
(All Ordinaries)



(a) Current data are monthly (period end) while Great Depression data are monthly average.
Source: Thomson Reuters, Wren Research (http://www.wrenresearch.com.au/downloads/).

As most other indicators demonstrate, however, Australia's experience in the two episodes was starkly different. Following five years of essentially no growth, real GDP fell by almost 10 per cent in 1930–31 (Chart 5). This had a predictably devastating impact on living standards, with real private consumption expenditure falling by one fifth from 1929–30 to 1930–31 while real private dwelling investment and imports halved. Real non–dwelling public investment halved over two years and did not recover to pre–Depression levels for a further six years. Following the huge collapse in 1930–31, the economy recovered, and real GDP grew at an average annual rate of 3.7 per cent over the subsequent five years.

Chart 5: Australian real GDP

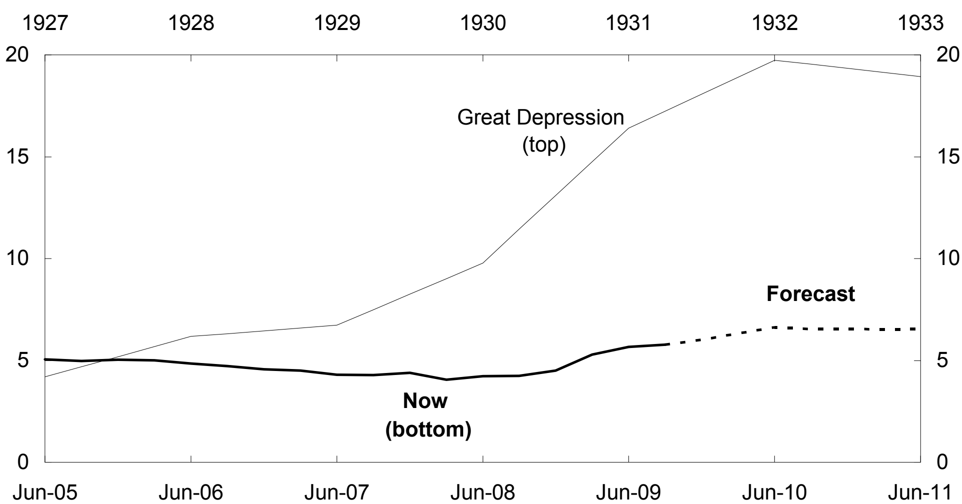


Source: RBA Statistics, Preliminary Annual Database, ABS cat. no. 5206.0 and Treasury.

In contrast, during the current global recession, Australian real GDP has risen in each financial year, and is forecast to continue to do so.

Australia recorded one of the highest rates of unemployment in the world during the Great Depression (Schedvin 1970). Before its onset, unemployment in Australia was already at 7 per cent in 1929. It reached 10 per cent in 1930 and peaked at 19¾ per cent two years later (Chart 6). Unemployment then began to fall by around 2 percentage points a year, to reach 9 per cent by 1937.

Chart 6: Unemployment rate in Australia
(per cent)



Source: RBA Statistics, Preliminary Annual Database, ABS cat. no. 6202.0 and Treasury.

The contrast with the current experience is stark indeed. While sluggish growth has seen the unemployment rate rise, the rise thus far has been only about 2 percentage points. The Government's recent Mid–Year Economic and Fiscal Outlook forecasts a peak unemployment rate of 6¾ per cent in the June quarter 2010 which, if realised, would constitute a rise of just less than 3 percentage points from its low of 3.9 per cent in February 2008.

However, these simple numerical comparisons do not capture fully the extraordinary hardship experienced during the Great Depression. As well as the much lower standard of living (with average per capita income at the onset of the Great Depression around one–fifth of its current level), the absence of a centralised federal unemployment assistance program at that time added immeasurably to the hardship of the unemployed.[4]

Other than relief from charities and an assortment of agencies and private organisations, the unemployed had to hope for employment projects and public works projects which were often reliant on state government loans from overseas — which, as we will see, had dried up as a source of funds by early 1929.

Main causes of the Great Depression in Australia

Let me now turn to three of the main causes of Australia's economic collapse during the Great Depression. These are: firstly, the extremely unfavourable global environment which, from Australia's point of view, manifest itself particularly in a large and prolonged fall in the terms of trade; secondly, Australia's adherence to the gold standard; and thirdly, Australia's loss of access to the London capital market from early 1929.

The terms of trade

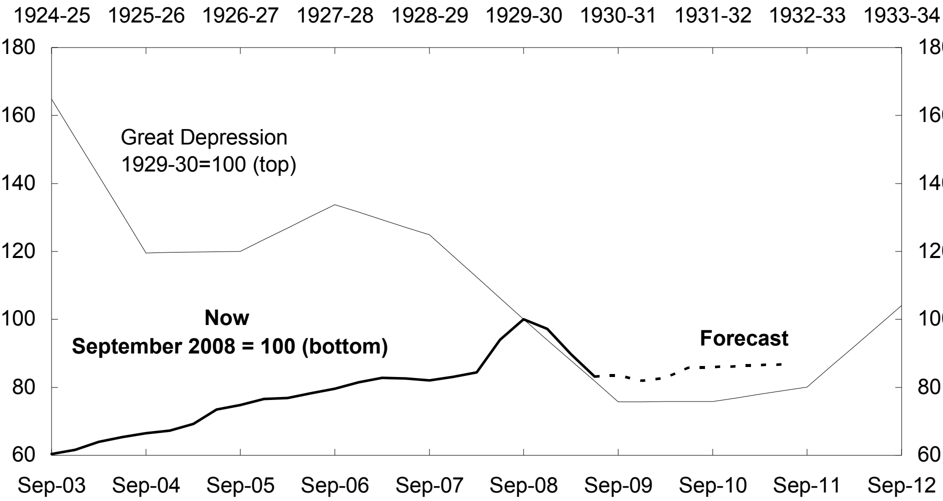
Australia suffered a large and sustained fall in its terms of trade in the mid–1920s, brought about by declines in the prices of Australia's major agricultural exports, particularly wool (Chart 7). This terms of trade fall, combined with Australia's

4 Commonwealth unemployment and sickness benefits were introduced in 1945 in the form of flat–rate payments financed from general revenue and subject to an income test. During the Great Depression, state governments had a support payment called 'the susso', short for sustenance payments. These varied by state but provided bare minimum support, with strict controls on what could be purchased with the coupons provided.

adherence to the gold standard (discussed later), played a key role in generating Australia's balance of payments crisis in the late 1920s.[5]

In contrast to the severe declines in the terms of trade in the years leading up to the Great Depression, Australia's terms of trade rose by about two–thirds in the five years to September 2008, to be at six–decade highs. The subsequent decline has so far been much less pronounced than at the time of the Great Depression — with the most recent (June 2009) level still more than 50 per cent above the average of the 1990s.

Chart 7: Australia's terms of trade



Source: RBA Statistics, Preliminary Annual Database, ABS cat. no. 5206.0 and Treasury.

The gold standard

Australia's exchange rate was determined by the gold standard in the lead up to the Great Depression.[6] After being suspended during the First World War, the gold standard was reinstated in Australia following Britain's return to gold in April 1925.

Central to the push to reinstate gold by central bankers in the major economies was a fundamental and long–standing mistrust of the capacity of a system of fiat money, not

5 Australia's exports were much less diversified at that time than they are today, both in terms of the commodity mix and the limited number of destinations to which the exports were sent. Agriculture accounted for 90 per cent of exports, with wool accounting for more than 40 per cent on its own. Around two–thirds of exports were sold to the UK and a few major European countries.

6 Under the gold standard, Australia's exchange rate moved within a narrow range, determined by gold points. Gold points were the level of the exchange rate at which it became more profitable to import or export gold instead of buying or selling bills of exchange at bank rates.

backed by gold, to deliver economic stability. This mistrust had been reinforced by the economic devastation wrought by the hyperinflation in the Weimar Republic in 1921-23. Although there had been previous hyperinflations, this was the first in a major country at the core of the global economy, and the first to be closely observed and documented by economists.[7]

It is arguable that the decisions taken by the key central bankers to re–establish the gold standard following its abandonment during the First World War was the primary cause of the Great Depression (see, for example, Ahamed 2009). It certainly rendered it near impossible for central banks across the world to run expansionary monetary policy in response to the collapse.

Given the massive terms of trade declines in the second half of the 1920s, the fixed exchange rate had a devastating effect on Australia. As the external position worsened during 1929, the exchange rate came under pressure. However, the private trading banks, and the Commonwealth Bank, attempted to resist devaluation and tried instead to maintain parity with sterling throughout 1930 — in part out of the fear of creating inflation (Butlin and Boyce 1985).

Meaningful devaluation of the Australian pound did not occur until early 1931. By March of that year, the Australian pound had depreciated by around 25 per cent against sterling (Chart 8).[8]

The decision of the trading banks to resist devaluation led to tight monetary conditions through 1930, which added to the problems of the depression (Butlin and Boyce 1985). Also, the policies of these banks, including the Commonwealth Bank, during 1931 and 1932 acted to delay the reduction in bank interest rates, thereby hampering recovery.

In addition, the low level of foreign exchange reserves in 1930 (a consequence of the failure to devalue earlier) prevented fiscal policy from taking a more active role, and actually forced government spending to be curtailed significantly (Fisher and Kent 1999), as we will discuss shortly.

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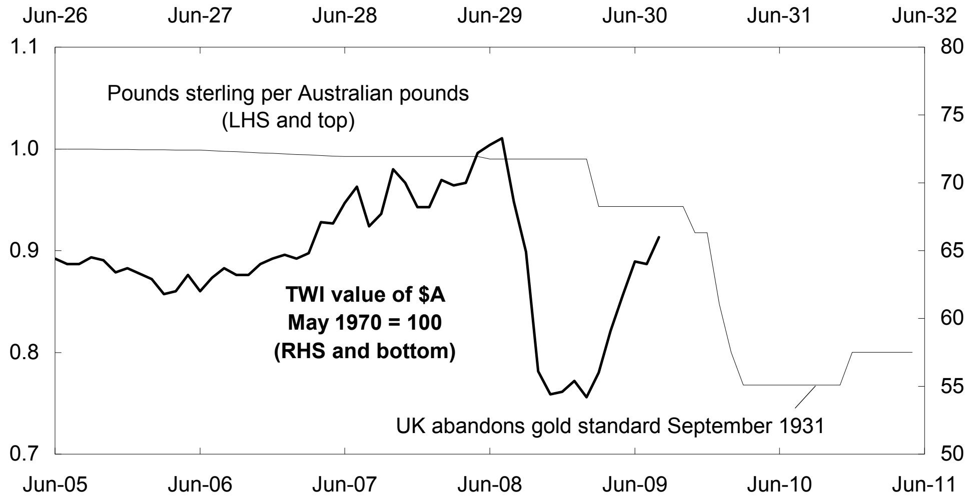
7 For more on this, see Ahamed (2009). The transition back to gold after the First World War was fraught with difficulties. Churchill's decision to set the gold price in Britain at its pre-war level forced substantial consumer price deflation, and prompted Keynes to voice his disagreement in *The Economic Consequences of Mr Churchill* (1925). Keynes continued to argue against the gold standard until it was abandoned in 1931.

8 Although there had been small divergences from strict parity (of around 1 per cent) from as early as 1928, devaluation of the Australian currency (which was then euphemistically known as 'developing a premium' on sterling) is recorded as beginning in December 1929, but these devaluations were small and relatively inconsequential. In December 1931 the Commonwealth Government fixed the exchange rate at 1 pound 5 shillings Australian per 1 pound sterling — a depreciation of 25 per cent — where it stayed for three and a half decades until the introduction of decimal currency in 1966.

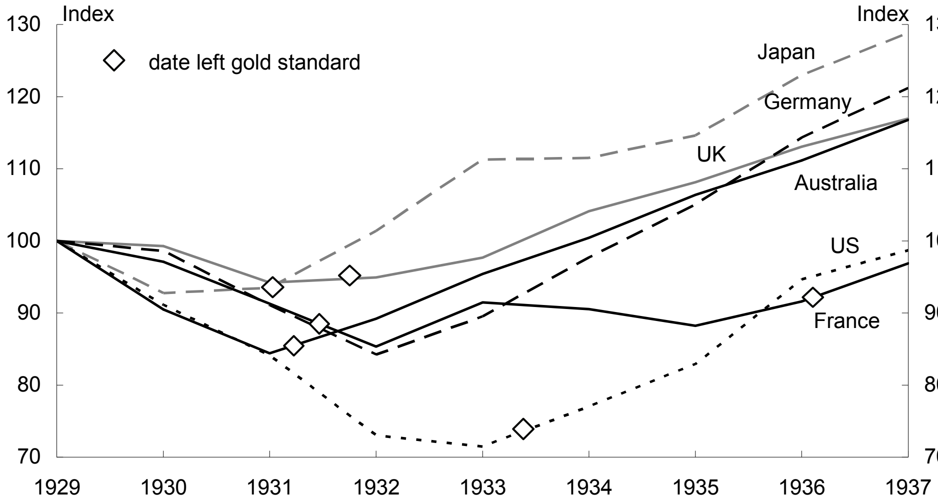
Chart 8: Australia's exchange rate against benchmark currencies[(a)]



(a) Great Depression data are spliced from financial year data to 1928–28 and monthly data from March 1930 (due to data limitations only the major devaluations are shown here).
Source: ABS cat. no. 5206.0, RBA Statistics, Preliminary Annual Database and Copeland 1934 (quoted in Kindleberger 1986).

Cross–country research has established a striking and revealing correlation: the sooner a country left the gold standard the sooner it recovered from the Great Depression (Eichengreen et al. 1985; Bernanke et al. 1990). Australia fits this pattern well; indeed, it is one of the countries that helped to establish it (Chart 9).

Chart 9: Real GDP and dates of exit from gold standard[(a)]



(a) While Germany went off gold in July and August 1931, it kept the value of the mark steady through the Nazi era, but controlled the flow of foreign exchange. Temin (1989) notes that the German chancellor followed the dictates of the gold standard in 1931 by maintaining high interest rates and deflating the economy. Australian data are not directly comparable to Australian GDP data employed elsewhere in the paper.

Source: GGDC-Maddison International Historical Database (http://www.ggdc.net/Maddison/), Bernanke et al. 1990.

In contrast, during the current crisis, Australia's floating exchange rate has played its expected role as a shock absorber for the Australian economy, first by depreciating rapidly (by around 25 per cent in the four months to November 2008), and then, after a period of months, recovering almost as rapidly.

Global capital markets and Australia's balance of payments

Australian governments borrowed heavily from the London capital market during the 1920s to fund a string of large infrastructure investments.[9] As a result, Australia's foreign debt increased rapidly. The Commonwealth and state governments ran overdrafts with London banks and paid them off by floating bond issues when either the sums became big enough to warrant it, or the banks providing the overdrafts became restless (Kindleberger 1986).

9 While New York was developing as a source of funds for Australian governments in the late 1920s the majority of borrowing was still done in London. Australia enjoyed trustee status in London due to the Colonial Stock Act of 1900, which gave it a privileged position relative to domestic (UK) borrowers. Australian governments generally were able to receive low–interest rates without much preliminary scrutiny (Schedvin 1970).

Borrowing by Australian governments was sufficiently strong that it accounted for 43 per cent of all British overseas investments in government securities over the period 1925–28 (Schedvin 1970). Rising British concerns about poor investment returns, combined with Australia's rapidly rising public debt levels and a severe balance of payments crisis, meant that this situation could not persist. In February 1929 an Australian loan was subscribed to only 16 per cent and had to be taken up by the underwriters. In April the London market refused to issue a loan and virtually ceased to be a source of funds for Australian long–term borrowing.

London banks then pressed Australian governments for payments on overdrafts. Gradually and reluctantly, the Australian banks were required to restrict advances, which put pressure on the local economy (Kindleberger 1986). The resulting cessation of borrowing was an important factor that constrained a more expansionary fiscal policy response to the Great Depression by the Commonwealth and state governments.

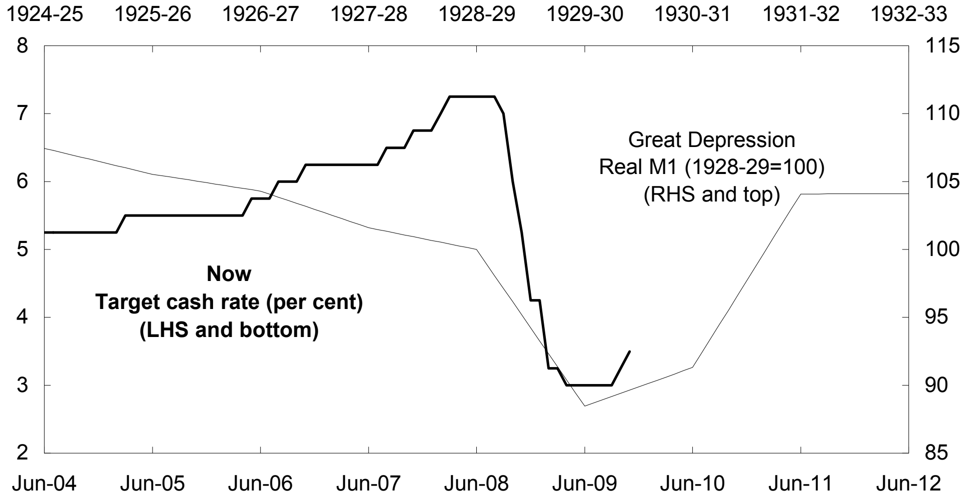
The contrast with today is again stark. Following the failure of Lehman Brothers in September 2008, and the actions of a series of governments in guaranteeing bank borrowings, borrowers lacking government guarantees were virtually shut out of world capital markets. With Australian banks' heavy reliance on offshore wholesale borrowing to fund their domestic operations, any incapacity to borrow in these markets would have had severe consequences for the domestic economy. But the strength of the Australian Government's balance sheet meant that it could, for a fee, offer a guarantee to the banks for their wholesale borrowings without risking the Government's AAA credit rating — which ensured continued access to global capital markets, in contrast to the situation 80 years earlier.

Monetary and fiscal policy

A comparison of monetary policy responses to the Great Depression and the current downturn is made more complex by profound changes in the operating procedure of monetary policy over the intervening years. Chart 10 shows the level of real M1 (M1 adjusted for changes in consumer prices) for the period surrounding the Great Depression, and the official cash rate for the current era.[10]

10 At the time of the Great Depression, M1 comprised currency held by the public plus current deposits at trading banks (Pope 1987).

Chart 10: Monetary policy response



Source: RBA Statistics, Preliminary Annual Database and RBA Bulletin.

After declining steadily before the onset of the Great Depression, real M1 dropped by 12 per cent between 1928–29 and 1929–30. This behaviour of real M1 supports other evidence that monetary policy was tragically tight as Australia succumbed to the Great Depression (Fisher and Kent 1999; Schedvin 1970).

Again, the contrast with the response of monetary policy to the current downturn could not be starker. Monetary policy was eased aggressively in late 2008 and early 2009, at a time when the exchange rate was depreciating rapidly. That this monetary policy response was possible without generating adverse market reactions (or unanchoring inflation expectations) is a testament to the credibility of the modern monetary policy framework, put in place in the aftermath of the early 1990s recession.

Australia's fiscal policy response to the Great Depression also exacerbated the downturn. While alternative policy responses were canvassed, Australia adopted a policy of controlled deflation.[11]

11 The other suggested alternatives were moderate fiscal expansion, and repudiation of the overseas debt obligations (known as 'the Lang Plan' after NSW Premier, Jack Lang).

In mid–1931, the 'Premiers' Plan' was agreed which focussed on financing the interest repayments to the British banks by large (20 per cent) cuts in government spending and an increase in federal and state taxation.[12]

The adoption of deflationary policies reflected the recommendation of Sir Otto Niemeyer. Niemeyer, having transferred from HM Treasury to the Bank of England in 1927, came to Australia in 1930. His arrival was a 1930s version of an International Monetary Fund 'mission' to a developing country in financial crisis, but rather than bringing financial resources, he brought stern advice (Coleman et al. 2006). The Premiers must balance their budgets immediately — in other words, a strongly contractionary policy at a time when national income had fallen dramatically, unemployment was high and rising, and budgets were in substantial deficit because of a major drop in revenue.[13]

In a celebrated accident of history, Keynes had come second to Niemeyer in the 1906 British Civil Service exams and, as a result, Niemeyer took the Treasury job Keynes would otherwise have had, while Keynes entered the India Office. We can only speculate what the implications would have been for Australia's economic fortunes in the Great Depression had Keynes beaten Niemeyer, and entered the Treasury.

Initially the Premiers' Plan was hailed as a success, but this verdict has not stood the test of time. Viewed from a modern perspective, with recognition of the importance of supporting aggregate demand when private sector spending is in retreat, Australia's policy responses to the Great Depression appear counterproductive, and certainly not supportive of recovery.

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12 The Commonwealth Government first accepted the deflationary approach in a 1930 conference which involved the state premiers and Prime Minister Scullin. It was there that the Commonwealth Government and all state governments decided to follow 'the Melbourne Agreement'. This involved decreasing welfare payments, reducing the basic wage by 10 per cent and abandoning public works projects — all in an attempt to rein in government spending. They also agreed to increase taxation in order to raise revenue (Fisher and Kent 1999). In May/June 1931 the deflationary elements of the Melbourne Agreement formed the basis of the Premiers' Plan, which was eventually agreed to be implemented by most state premiers and the Commonwealth Government. A report by a committee of Professors Copland, Giblin, Shann and Melville in May 1931 helped lay the basis for the Plan. It also proposed reductions in interest rates, but adherence to the gold standard prevented this from occurring during 1930, and even when the gold standard was abandoned, banks had little reserves left with which to extend credit (Fischer and Kent 1999).

13 The Commonwealth Government suffered sharp and sustained falls in customs revenue in the Great Depression while the state governments suffered major reductions in receipts from government businesses — which were then their major source of revenue.

Reflecting on these events many years later, Colin Clark was of the view that the Plan was based on mindlessly following public opinion in opting for balanced budgets, regardless of the state of the economy.[14]

Of course, as we have seen, a combination of external circumstances and the rapid growth in public debt through the 1920s meant that choices were limited. The Commonwealth Government and the Commonwealth Bank resisted proposals for loans to the state governments for public works and job creation on the grounds that they had to conserve their sterling foreign exchange reserves (Clark 1958). Colin Clark notes of the Commonwealth Government (1958 p 226):

> One can understand their predicament; but it is hard to condone their scale of values. Almost any alternative measure would have been preferable to leaving hundreds of thousands of men unemployed for ten years.

During the Great Depression the aggregate government budget balance (for the Commonwealth and state governments) declined from a deficit of 0.5 per cent of GDP in 1928–29 to a peak deficit of 4.0 per cent of GDP in 1930–31 before falling to under 1 per cent two years later (Chart 11). This rise in the budget deficit over these years was a consequence of the collapse in the economy, rather than a result of deliberate expansionary policy.[15]

14 Clark (1958, p 222) noted that the Premiers' Plan to balance Commonwealth and state budgets '[w]as certainly harmful. This action prolonged the depression and made unemployment very much worse than it would otherwise have been'.

15 Clark (1958, p 221) noted that: 'In 1930, quite apart from the question of finding any money to occupy the unemployed, the budget deficit was rapidly enlarging. The Commonwealth Bank, however, declined to lend the Commonwealth or state governments any more money. Whether or not one approves of the politics of this decision, it was certainly extremely bad economics. The most abundant expenditure of loan money and the largest deficit would have been fully justified at such a time'. Much of the Federal Government deficit during the early 1930s appears to have been financed by the sale of Treasury bills to the Commonwealth Bank (although precise data are not readily available). Fisher and Kent (1999) note that the extent of this finance was limited by the Commonwealth Bank because of its fears regarding inflation over the longer term. The Commonwealth Bank also pressured the Government to reduce the stock of outstanding Treasury bills from 1932 until the end of 1935 (Fisher and Kent 1999).

Chart 11: Aggregate Government budget balance[(a)]
(per cent of GDP)

(a) Aggregate Government includes Australian Government and state–territory governments. Australian Government data for the current period are underlying cash balance from the 2009–10 MYEFO. Data from 2009–10 are estimates. State–territory data are equivalent to receipts (from operating activities and sales of non–financial assets) minus payments (for operating activities, purchases of non–financial assets and net acquisition of assets under finance leases). 2007–08 state–territory data are from ABS Government Finance Statistics. 2008–09 to 2012–13 are from States' 2009–10 Budgets with the exception of the ACT which are from its 2009–10 Budget update. 2008–09 data for Qld, Victoria, NSW, WA, Tasmania and the NT are based on 2008–09 final budget outcomes.
Source: Barnard 1987 (Table GF 1–7) and Treasury.

Indeed, real aggregate government expenditure fell by 9 per cent from 1928–29 to 1931–32 — and by 19 per cent in nominal terms (Barnard 1987). Within the expenditure categories, charges for debt increased in the 1930s, in part because of the impact of devaluation on debt denominated in pounds sterling.[16]

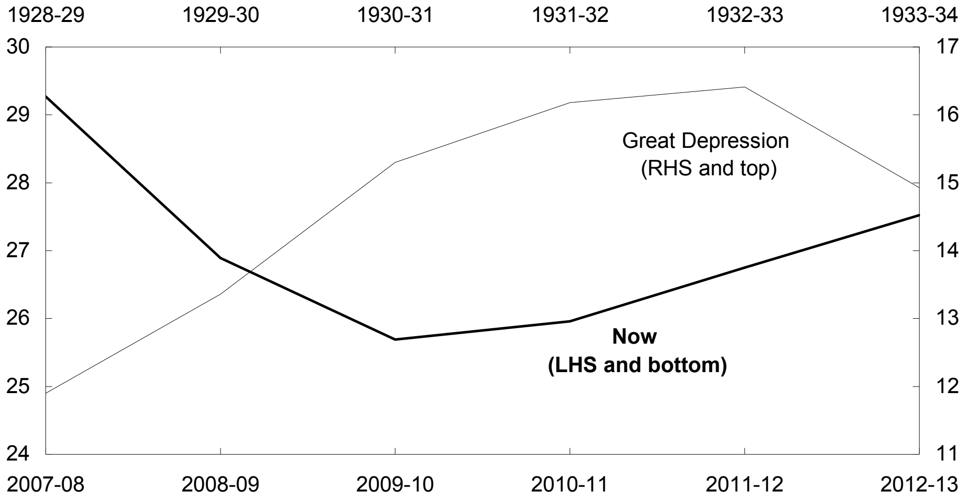
During the current downturn, the Australian Government budget balance (underlying cash) went from a surplus of 1.7 per cent of GDP in 2007–08 to a deficit 2.3 per cent in 2008–09 and an expected 4.7 per cent of GDP in 2009–10, before declining. The swing from surplus in 2007–08 to deficit in 2008–09 was driven by both the largest collapse in Australian Government revenue since the Great Depression, and the discretionary fiscal stimulus packages.[17]

16 Perkins (2008) notes that a significant proportion of both Commonwealth and state budget outlays at the time were interest payments on debt owned by UK bondholders.

17 Australian Government total receipts for 2008–09 were $20 billion, or 6.5 per cent, below the estimate in the *2008–09 Budget* (Treasury *Final Budget Outcome 2008–09*). This is the largest fall in receipts compared to the budget year forecast since 1930–31, when the shortfall was 17 per cent.

In the 1930s, the tax base was broadened with increases of existing tax rates and the imposition of new taxes to offset the falls in customs revenue due to reduced imports. Tax receipts as a share of GDP rose by over four percentage points between 1928–29 and 1932–33 (Chart 12). In contrast, during the current downturn, the tax take is estimated to fall by about 3½ per cent of GDP due to a combination of automatic stabilisers and tax cuts.

Chart 12: Aggregate Government tax receipts[(a)]
(per cent of GDP)

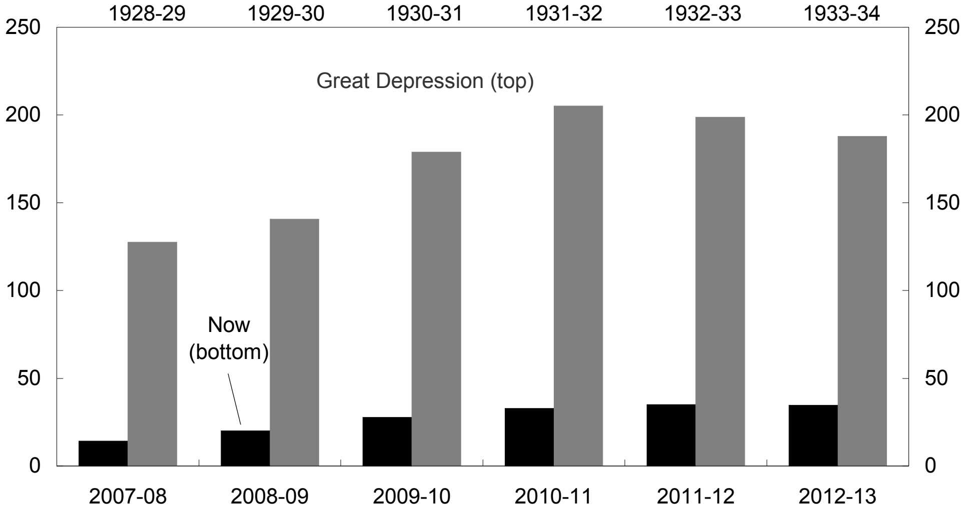


(a) Aggregate Government includes Australian Government and state–territory governments. Australian Government data for the current period are from the 2009–10 MYEFO. Data after 2008–09 are estimates. State–territory data for 2007–08 are from ABS Government Finance Statistics. 2008–09 to 2012–13 are from States' 2009–10 Budgets with the exception of the ACT which are from its 2009-10 Budget update. 2008–09 data for WA, Vic and NT are from final budget outcomes 2008–09.
Source: Barnard (1987), Table GF 1–7 and Treasury.

As I have already noted, Australia lost access to the London capital market in 1929 because of high levels of government debt which severely constrained fiscal policy responses to the crisis. Total government gross debt was already well over 100 per cent of GDP before the onset of the Great Depression (Chart 13). With fixed interest loans denominated in pounds sterling these levels increased to a peak of 205 per cent of GDP in 1931–32.

During the current downturn, gross debt for all levels of government has also risen, and is estimated to peak at around 35 per cent of GDP over the next few years.[18]

Chart 13: Aggregate Government gross debt[(a)]
(per cent of GDP)



(a) Aggregate Government includes Australian Government and state-territory governments. Australian Government data for the current period are from the 2009 MYEFO. Data after 2008-09 are estimates. Commonwealth Government securities on issue is used for the current period. State-territory data are borrowings of non-financial public sector entities. 2007–08 data are from ABS Government Finance Statistics. 2008-09 to 2012-13 are from States' 2009-10 Budgets with the exception of the ACT which are from its 2009–10 Budget update. 2008-09 data for WA, Vic and NT are from final budget outcomes 2008-09.
Source: Barnard 1987 (Table GF 1–7) and Treasury.

What have we learnt?

At the time of the Great Depression, Australia's macroeconomic policy frameworks were tragically ill equipped to cope with anything other than small, inconsequential macroeconomic or financial market shocks. Faced with a shock the size of the Great Depression, they were simply overwhelmed.

The lessons learnt from that disastrous experience have informed the macroeconomic policy frameworks of today.

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18 Around half of this is Australian Government gross debt, which is projected to increase from 5.2 per cent in 2007-08 to a peak of 18 per cent of GDP in 2011–12 (when Australian Government net debt is projected to be 8.9 per cent of GDP). Interestingly, the US experience is quite different in the two episodes. US Federal debt held by the public during the Great Depression rose from 15 per cent of GDP in 1929 to 44 per cent five years later. During the current crisis, it is projected to rise from 44 per cent of GDP in 2008 to 61 per cent by 2010 (CBO 2009).

An intellectual revolution in our understanding of the behaviour of the macroeconomy has made possible a complete redesign of both the institutional arrangements in which the macroeconomy operates, and the policy responses to macroeconomic or financial market shocks.

A key element of this intellectual revolution, associated with Keynes' General Theory, is recognition of the importance of supporting aggregate demand in the economy at times when private sector demand is in retreat.

An important corollary to this recognition, however, is that to be in a position to provide such support at such times requires a credible medium–term framework for macroeconomic policy. Such a framework enables policy actions designed to support aggregate demand in the short term to be explained in the context of the medium–term framework.

In the case of monetary/exchange rate policy, the redesign of the framework has been a profound one. The gold standard no longer sits at the core of the system. The gold standard was clearly successful in ruling out any possibility of sustained high inflation or hyperinflation, but it was woefully inadequate when the economy was faced instead with a severe contractionary shock.

By contrast, the key elements of the modern monetary policy framework are, of course, a floating exchange rate and an independent central bank committed to medium–term price stability. Once credibility for this framework has been established, it provides a clear, medium–term anchor for inflation. Importantly, however, it also provides the capacity for monetary policy to respond flexibly — and if need be rapidly and aggressively — to short–term macroeconomic shocks. This flexibility has been particularly important in the face of shocks to Australia's terms of trade.

The rapid easing of Australian monetary policy in late 2008 and early 2009 is an impressive example of this flexibility in action. That this monetary policy response did not generate adverse market reactions or unanchor inflation expectations, despite it occurring at a time when the exchange rate was depreciating rapidly, is a testament to the credibility of the modern monetary policy framework.

For fiscal policy, Australian governments borrowed so heavily in the 1920s that Australia was cut out of the London capital market when the economic outlook deteriorated in 1929. The contrast with recent times is stark. From the mid 1980s onwards, Federal Governments of both political persuasions have demonstrated the resolve needed to bring deficit budgets back into surplus after the economy has recovered from recession, and have committed themselves to increasingly well-articulated medium–term frameworks for fiscal policy. The discretionary fiscal policy actions in late 2008 and early 2009, which provided substantial and rapid support to aggregate demand at a crucial time, were undertaken in the context of a medium–term fiscal framework that included an explicit, articulated strategy to return the budget to surplus once the economy returned to above–trend growth.[19]

All these elements together (along with an improving external environment, strongly supported by expansionary monetary and fiscal policies in the rest of the world) have made possible a radically different outcome to the current global recession than would have been possible with the macroeconomic policy frameworks in place at the time of the Great Depression.

These outcomes would surely be gratifying to those economists, including Colin Clark, who worked over the intervening decades to develop the economic and statistical tools to better our understanding of the macroeconomy and help prevent the devastation of another Great Depression.

19 I leave to another day a discussion of the reasons why discretionary fiscal policy fell out of favour in recent decades, but was embraced in response to the global financial crisis of 2008-09, and played a crucial role.

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Key themes from Treasury's Business Liaison Program

As part of Treasury's Business Liaison Program, staff met with around 25 organisations in Sydney, Melbourne, Brisbane and Perth during November 2009.[1] Treasury greatly appreciates the commitment of time and effort by the organisations that participate in the program.[2]

Businesses generally reported improved conditions in the September quarter and increasing optimism about the sustainability of a recovery. However, given the degree of spare capacity in the economy, the weakness in business investment (particularly outside the resources sector) looks set to continue. Labour market conditions have strengthened in line with an improving economy. Wage and price pressures remain subdued.

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1 A detailed explanation of the Treasury Business Liaison Program is provided in the Treasury *Economic Roundup*, Spring 2001.

2 This summary reflects the views and opinions of participants in the liaison program, which are not necessarily shared by Treasury. While Treasury's evaluation of the economic outlook is informed by findings from business liaison, a much wider range of information and data are utilised to ensure a rigorous assessment of the Australian economy. Treasury aims to meet with a broad cross-section of the business community over time. Companies are invited to register their interest in participating.

Trading conditions

With stimulus payments to households having their peak impact in the June quarter, previous liaison had revealed a concern that retail sales would weaken over the second half of 2009. Through-the-year growth in sales had slowed in the September quarter, with conditions stabilising since then. Historically low interest rates, improving economic conditions, rebounding asset prices and the strength of the currency were identified as supporting consumer confidence and demand. With the December quarter always the strongest in seasonal terms, contacts were hopeful the generally favourable trading environment would continue through the Christmas period.

Mining sector contacts had weathered the downturn better than expected, and were reporting improvements in traditional export markets for mineral and energy commodities. Some had compensated for the weak demand in contract markets such as Japan, Korea and Europe by redirecting volumes to China with spot market sales. With a recovery in traditional markets, there was less spare capacity to satisfy Chinese demand and capacity expansions might be brought forward as a result. While the currency appreciation had offset much of the recent recovery in global commodity prices, export volumes were clearly strengthening.

Transport sector contacts also saw emerging signs of a recovery with international passenger and container movements now higher than a year ago at major airports and ports. In contrast, domestic passenger and container volumes were largely flat compared to a year ago. Additional capacity from new entrants combined with aggressive fare discounting had supported international passenger volumes, particularly in the outbound market; whereas the domestic business travel market remained subdued for most of 2009.

Domestic manufacturing sector activity was apparently not particularly strong. This pattern could reflect a degree of import substitution in response to the strength of the currency. Recent private sector surveys indicate that while the domestic manufacturing sector is now expanding, businesses remain cautious about the durability of demand and are yet to rebuild inventories to a significant degree.

The construction sector continued to receive strong support from fiscal stimulus and record public sector capital expenditure programs. However, significant variations were evident across the sector with the greatest weakness in new office and retail developments. Although the flow of new developments remains subdued, there were signs of improvement in the commercial property market with the volume of transactions picking up off a very low base and asset prices and yields stabilising, although vacancies may not yet have peaked.

The housing market was being supported by first home buyer activity, and more recently existing home owners seeking to upgrade. Investor activity remained subdued, and residential developers continued to face difficulty in getting medium-density and high-density projects off the ground.

Business credit and investment

The cost and conditions attached to bank credit were again raised as a concern, though outside of the commercial property and residential property development sectors, there were fewer indications of credit supply being constrained. Higher margins and more restrictive lending conditions had supported the trend of larger corporations accessing capital markets directly, where possible. Smaller to medium-sized firms appeared generally able to access bank credit, but could be deferring expenditure and continuing their deleveraging until economic and financial conditions become more favorable.

With the exception of the resources sector, contacts reported that planned expansions would remain on hold until the significant existing spare capacity had been absorbed. As such, many expected general weakness in capital expenditure for perhaps another 12 to 18 months. That said, the deferral of discretionary maintenance during the downturn had led to a backlog of work in some sectors, to the point that a resumption of usual maintenance programs was now expected, given improved confidence and underlying conditions.

Capacity issues

The impact of the Government's stimulus packages on the building construction sector was explored again during this liaison round. Contacts advised that there were few signs of public spending leading to capacity constraints or cost pressures in the relevant sectors. Indeed, with very little other work occurring, public expenditure was seen to be helping to fill a large gap in private building activity.

Exports of coal and liquefied natural gas (LNG)

Several contacts reported their optimism regarding the expansion of the New South Wales coal export supply chain, following the long-term agreements concluded in recent months. Expectations were that the export capacity of the supply chain could now be expanded relatively quickly, with the first increment coming on line in the first half of 2010. Additional expansion projects could see capacity grow much more significantly over coming years.

The outlook for Australia's LNG exports in coming years is also very positive, with potential large-scale investment extending well into the next decade. Contacts commented that although the global recession had weakened demand, the outlook for Australian LNG projects looked quite positive on balance. The extent of the supply response from other countries will likely determine the viability of several prospective projects, such that not all of the slated projects would proceed. A factor that could support development of the sector is the desire of buyers to diversify their sources of energy supply.

Employment and skills

Contacts suggested that the outlook for employment had improved a little, with the finance, sales and marketing and construction sectors showing signs of growth. Small to medium-sized employers had been the first to begin hiring from around the middle of the year, and the signs were that larger companies were beginning to add staff. Demand for specialist skills, particularly engineers with mining sector experience and skilled construction staff, has remained strong.

Prices and wages

The strength of the Australian dollar and favourable seasonal conditions were driving down the price of fresh produce, and this was being passed through to customers. Retailers anticipated the currency appreciation would also be passed through into 2010 as the effects flowed through the supply chain.

Wage pressures remained subdued, with the strongest growth in the mining sector. In most other sectors wages were generally tracking below inflation. Wage and salary freezes were still in force across a number of firms.

The extent of spare capacity in the economy was also serving to moderate input price pressures throughout the supply chain, and contacts expected this to continue on the basis that the full effect of the currency appreciation was yet to be passed through.

Earle Page: an active treasurer

John Hawkins[1]

Earle Christmas Grafton Page brought down six Budgets while serving as Bruce's treasurer. He was fortunate in when he was treasurer, after the war and before the Depression, which allowed him to ease tax burdens. Bruce and Page established the Loan Council and the National Debt Sinking Fund and introduced 'tied grants' to the States.

Page moved the Commonwealth Bank further towards being a central bank and gave it responsibility for the note issue.

Source: National Library of Australia

1 The author was formerly in Domestic Economy Division, the Australian Treasury. This article has benefited from discussions with Selwyn Cornish and the assistance of the Reserve Bank archivists. The views in this article are those of the author and not necessarily those of the Australian Treasury.

Introduction

As well as being a long-serving treasurer, Sir Earle Page PC GCMG served as prime minister for 20 days and was often acting prime minister. Only Billy Hughes has served a longer term in the House of Representatives.

But as well as possessing longevity, Page was also innovative. His private secretary recalls him as 'a combination of dreaming idealist and intensely practical man of affairs'.[2] Indeed, he was described as 'energetic, almost incoherent as he poured out ideas faster than words would come in an orderly fashion', peppered with his trademark 'you see, you see'.[3] He not only had a lot of energy for his ideas and his politics. Physically robust, Page played a daily hard game of tennis until he was over 80, and 'he played it as he played the political game, with reckless energy, native cunning and a certain contempt for the orthodox rules of the game'.[4]

His energy was accompanied by an ability to get on well with most of his colleagues. While 'self-centred to an extraordinary degree', he was also charming and amiable.[5] There were exceptions — he famously clashed with Hughes and Menzies, successfully vetoing Hughes as prime minister but failing to do the same with Menzies.

Page's life before politics

Page was born in Grafton on 8 August 1880, one of eleven children. His father, a businessman and mayor of Grafton, had been financially ruined in the 1890s depression and bank runs (which was an important influence on Page's subsequent interest in central banking). Nonetheless, Page looked back fondly on a childhood in an isolated but friendly community in a sylvan setting. For all his life the beauty of the Clarence River area was a tonic for him. After winning scholarships enabling him to study medicine at the University of Sydney, where he topped his year, he joined Royal Prince Alfred Hospital. Here he met his future wife, Ethel Blunt, a nurse who tended him after he contracted a near fatal infection. Page set up practice in Grafton, where he later opened a hospital offering new technologies such as x-rays and owned the first car in the region. During World War I Page served for 16 months with the Army Medical Corps in Egypt and France. Page prospered, and invested in property and the local newspaper.

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2 Ellis (1963, p 323).

3 Edwards (1965, p 81). Similar views are expressed by his cabinet colleagues: see for example George Pearce (1951, p 171), Arthur Fadden (1969, p 82) and Enid Lyons (1972, p 75).

4 Ellis (1963, p 324). A similar view is put by Bridge (1988) and Alan Reid, *Bulletin*, 29 January 1980, p 363.

5 Ellis (1963, pp 323-4).

Into federal parliament

Page had long had political interests, such as support for a new state in New England[6], improved rail links and hydroelectric generation through a dam on the Clarence. In 1913 he was elected to the South Grafton shire council and in 1918 became mayor and formed the Northern NSW Development League. In 1919 he won the federal seat of Cowper, based on Grafton, as an independent candidate backed by the Farmers and Settlers Association. Once in parliament he joined with like-minded members to form the Country Party. He was initially appointed secretary and whip and in April 1921 took over from the interim leader, Bill McWilliams. Page also served as the Country Party's inaugural federal chairman, serving from 1926 until his death in 1961.

When the Nationalist treasurer Joseph Cook brought down the Budget in October 1921, it provided for a deficit. Page referred to deficit financing as a 'rake's progress'.[7] The Country Party moved for expenditure cuts to bring it back to balance, and came within a single vote of bringing down the government. Page was more impressed by Bruce's Budget in 1922, which cut a number of taxes, and which Page later said he regarded as a model for his own Budgets.[8] Page congratulated Bruce on his 'lucidity and clearness' but regretted he had not been firmer in halting expenditure.

Page led the Country Party into the 1922 election, including among his policies the establishment of a National Debt Sinking Fund and a national insurance scheme for sickness, unemployment, poverty and age.[9] He also called for the conversion of the Commonwealth Bank into 'a Central Bank … making it the bank of Exchange, Discount and Reserve'.[10]

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6 For example, Page (1922). This had been a cause championed by Page's grandfather from 1861 and his uncle from the 1880s; Page (1963, p 3).

7 Ellis (1963, p 64).

8 Page (1963, p 84).

9 *Daily Telegraph*, 27 October 1922, p 5.

10 Page (1963, p 86). This has many echoes of the proposal put forward by King O'Malley (1908), whom Page regarded as a 'lifelong friend and adviser'; Page (1963, p 113). O'Malley in turn regarded Page as 'the best treasurer Australia has ever had'; O'Malley to Page, 12 February 1924, Page papers, NLA MS 1633/344. Another influence was the international monetary conference in Genoa in 1921 which recommended the establishment of central banks. Page (1963, p 115) says the conference 'substantiated my own conviction'.

Treasurer

Page and Bruce

Hughes failed to win a majority for his Nationalist Party at the December 1922 election. The Country Party refused to join a coalition under Hughes and so Hughes reluctantly ceded the leadership to Bruce.[11] As prime minister, Bruce allowed the Country Party a lot of influence — it held five of the eleven ministries[12] and Page was deputy prime minister and treasurer. The government was known as the Bruce-Page government.[13] Page became the fifth treasurer in five years.

He was an active treasurer. He cited Pitt's axiom that 'finance is government and government is finance'.[14] As noted in the preceding essay on Bruce, how much of the economic reforms of the Bruce-Page government were due to Page is not clear. Page characterised his relations with Bruce as 'intimate and cordial'.[15] One contemporary observer said that 'so far as the finances of the country were concerned, major decisions as well as most of the details were left to the treasurer'.[16]

Bruce painted the following picture of his treasurer:

> He used to come down from his office to mine practically every morning. He had new brainwaves every day. They were nearly always half-baked ... but if

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11 Page had campaigned on a 'Hughes must go' platform. Hughes disliked Page and dismissed him as a 'hayseed'. By contrast, Bruce as an importer was more sympathetic to the Country Party's preference for low tariffs, and was of a similar age. Both Bruce and Page served in the war and had successful careers before parliament. Page may also have hoped that in tearing down Hughes he might inherit the post himself; Ellis (1963, p 328).

12 Gradually reduced to five out of 13 by 1928.

13 While coalition governments have been common in Australia, the short-lived Reid-McLean was the only other to be named after two leaders.

14 *Hansard* (12 October 1922, p 3792) and Page (1963, p 126).

15 Page (1963, p 103). Graham (1961) describes them as getting on well. Page's political secretary described the government as 'the instrument for a unique partnership between these two complimentary personalities imbued with similar broad objectives, based on mutual confidence and trust and strengthened by a sense of personal companionship in a shared and inspired enterprise'; Ellis (1963, p 100). On the other hand, Page could sometimes be a trial, and Bruce's typist recalled he 'was sometimes pretty short with him'; Crisp papers, NLA MS5243/20/211. 'Cynics claimed that much of Page's affection for Bruce stemmed from Bruce's willingness as prime minister to let Page have his country party head as Treasurer'; Alan Reid, *Bulletin*, 29 January 1980, p 363. One area where Page clearly deferred to Bruce was in not pursuing his interest in new states; Marshall (1987, pp 77-8).

16 Buchanan (1940). Indeed, Bruce thought that interfering in the minister's handling of the portfolio 'simply wasn't done'.

> you had the patience to listen to Page, he'd come up with a helluva good idea now and then.[17]

Page's own account was, '[i]f I presented some new or startling proposal he would cross-examine me for hours on every phase; ruminate on the problem for a day or two, expound its details with the utmost clarity, and often suggest modifications or amendments which would strengthen its foundations'.[18]

Budgets

Page rearranged the presentation of government accounts in the Budget to distinguish departmental expenses from government business enterprises, payments to States and interest. He prided himself on presenting Budgets in the first month of the financial year.[19]

Page's early Budgets were aided by the relative prosperity of the times. He abolished land tax, cut income tax and established a National Debt Sinking Fund. An investment fund financed the Council for Scientific and Industrial Research.

Page as treasurer supported development, but this was manifest more in measures such as expansion of postal services rather than some of his more visionary schemes for irrigation and hydro-electricity.[20] Page sponsored Australia's first national housing program.[21]

In 1927 falling customs and income tax brought the budget into deficit. Page was vulnerable on financial issues but until the arrival of Theodore there were no Labor members with the technical ability to put him under pressure.[22] (Page had an eye for talent and had made strenuous efforts in 1923 and 1924 to get Theodore to switch sides.[23])

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17 Interview by C Edwards (cited in his 1965 biography, p 82), the original tape of which is available at the National Library of Australia. Fadden (1969, pp 81-2) has a similar view of Page, referring to 'a veritable flood of ideas on every conceivable subject'.

18 Page (1963, pp 103-4).

19 An exception was 1927 when the Budget was delayed by the move of the parliament to Canberra. Page's Budget speeches did not impress Schedvin (1970, p 88), who said '[t]hese read more like a Chairman's address to the annual meeting of a large public company than the nation's principal document on economic policy. They are just as dull, and as effectively skirt the main issues'.

20 Marshall (1989, pp 88-92).

21 Lloyd (1984, p 15); Curtis (1955, p 305).

22 Young (1971, p 74).

23 Young (1971, p 43).

In the September 1927 Budget debate, Henry Gullett, a Nationalist backbencher, rounded on Page's 'spendthrift budget', calling him 'the most tragic treasurer Australia has ever known', a sobriquet that stuck.[24]

Signs that the economy was not well started to emerge in 1928, with unemployment rising. In his 1929 Budget speech Page referred to a 'temporary financial depression' but reassured listeners 'this condition is merely a passing phase'.[25]

Towards central banking

Once treasurer, Page could act on his plans for the Commonwealth Bank. In June 1923 Page sought the views of deputy governor James Kell who supported the Bank taking on more of a central banking role. While the terms 'national', 'central' and 'reserve' bank were often used interchangeably, they represented conceptually different emphases for the future role of the Bank.

Kell wanted the Bank to develop a reserve banking role; the Commonwealth Bank as a 'bankers' bank'.[26] This reflected an interest in promoting what would later be called 'financial stability'. The private banks were required to settle across the books of the Commonwealth Bank.[27] A proposal to require them to hold 5 per cent of their funds with the Bank was withdrawn after the private banks strenuously objected.[28]

Kell was also interested in the Bank becoming a 'national' bank and advocated building up its savings bank business.[29] In 1927 savings bank activities were placed in a separate department and mortgage lending for housing encouraged.

24 *Hansard*, 16 November 1927, p 1495. Magnanimously, Page agreed to Gullett joining the cabinet the following year.

25 *Hansard*, 22 August 1929, pp 225 and 240.

26 'Strong proprietary banks are … the bulwark of a country, and a strong National and Central Bank to which they can turn in times of financial crisis is the most effective safeguard against financial panic'; Kell to Page, 29 June 1923, RBA (records in the custody of the Reserve Bank of Australia Archives) GJK-23-1. Armitage, the Bank's secretary, suggested a more evolutionary approach; 'the Commonwealth Bank will take on a reserve banking role by a natural turn of events'; Armitage to Page, 28 June 1923, RBA GHA-23-1.

27 Governor Miller had suggested they do so in 1921 but the private banks declined; Harper and Schedvin (1998, p 222).

28 Cornish (2008, p 8).

29 'With regard to the Savings Bank portion of the business, I consider this an essential to the proper development of a truly National and Central Bank … it is necessary for the savings of the whole of the Australian people to be centralised in its National Bank.'; Kell to Page, 29 June 1923, RBA GJK-23-1.

A 'central banking' role (in the macroeconomic policy sense) was more problematic. There had only been small steps in this direction by 1923. The Commonwealth Bank was developing a role in influencing the exchange rate.[30]

The question of control of the Bank was contentious. The Government announced it would be placing the Bank under an independent board, and it was referred to in Page's Budget speech. The details were worked out between Page, Bruce and the treasury secretary Collins, and the Bill introduced to parliament in June 1924. The board was to comprise the governor, the treasury secretary, two representatives from commerce, two from primary industry and two from finance or industry.[31] An early draft required two of the appointees to have a specialist knowledge of currency matters but this provision was dropped.[32] A draft that went to cabinet envisaged private shareholders.[33]

In 1920 Cook had transferred banknote issue from Treasury to an independent department of the Commonwealth Bank, under its own Note Issue Board. Cook's 'intention was for the note issue to contract and expand automatically according to business needs'.[34] However, the Board had other ideas. Its policy of contracting the note issue to reduce domestic price levels was aimed at returning Australia to the gold standard at its pre-war parity.[35] The Note Issue Board would not even allow the note issue to respond to seasonal variations in demand. This approach antagonised business, banks and rural producers. Page took the opportunity of the 1924 legislation to abolish the Board and bring note issue under the control of the Bank.[36]

The Australian Government decided to return to the gold standard in March 1925, putting pressure on the UK to follow suit soon after. Australia's readoption of the gold standard was not announced until after the UK made a similar pronouncement.[37] This disguised what was arguably Australia's first explicit macroeconomic policy decision.[38]

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30 The Bank's secretary commented: 'the Commonwealth Bank has also been able to exert considerable influence in regard to rates of exchange … on several occasions when the Associated Banks were desirous of increasing the rates to the public, the Commonwealth Bank was able to check them from doing so'; Armitage to Page, 28 June 1923, RBA GHA-23-1.

31 Schedvin (1970, pp 83-4) and Giblin (1951, pp 31-2) profile the board members.

32 Giblin (1951, p 20). Page papers MS 1633, folder 344 contains some early drafts.

33 Page papers, NLA MS 1633, folder 344.

34 Murdoch (1996, p 133).

35 Cornish (1988) and Cornish (2008, p 4).

36 Page's draft had a provision whereby control of the note issue could be resumed by the Treasury by proclamation, but this was amended away by the Senate; Giblin (1951, p 20).

37 Tsokhas (1994); Cornish (2008, p 5).

38 Cornish (1988, p 1).

The Commonwealth Bank was also empowered to fix and publish its discount rate and given the responsibility to prepare more statistics. Further reforms in 1925 saw the establishment of the Rural Credits Department in the Commonwealth Bank, half of whose profits would be used to fund agricultural research. This was clearly a Page initiative, based on his original idea of a Rural Credits Bank.[39]

For Page these were 'a first step towards a central banking system'.[40] He believed 'the important functions of banking can properly be performed only with the guidance and control of a central bank'.[41]

In 1928 a Bill was drafted to increase central banking powers, but was not introduced.[42]

Fiscal federalism

In his first Budget, Page expressed concern about fiscal federalism; '[i]t is most undesirable that one government should be responsible for raising the money required to meet the expenditure of another. A most salutary check against extravagance is provided when the government spending money has to justify its actions to the taxpayers whose money is involved'.[43] Bruce and Page were keen to make federalism work, but at the 1923 Premiers' Conference could not get consensus.

Bruce and Page established the Loan Council in 1924 and a referendum in 1928 made it a statutory body. Bruce proposed abolishing the 25 shillings per head payment to the States enacted in 1911 at his first Premiers' Conference in 1923 but no agreement was reached. Eventually he decided to proceed unilaterally, but had it ratified by a rare successful referendum held concurrently with the 1928 election. Bruce and Page established the 'tied grants' scheme, initially for road building (notably including a bridge over the Clarence River in Page's own electorate).

National insurance

Page noted in his first Budget that while invalid and old age pensions were a large and growing burden on taxpayers, the system still did not 'remove that sense of cruel insecurity which haunts great masses of our people through the whole of their life — the fear that accident or temporary sickness may break up their home, the continual

39 Marshall (1987, pp 167-8).
40 *Hansard*, 13 June 1924, p 1269.
41 *Hansard*, 13 June 1924, p 1265.
42 Cook (1971, p 117). Schedvin (1970, p 86) suggests that this draft Bill later formed the basis for the Central Reserve Bank Bill introduced by the Labor Government in early 1930. Giblin refers to a more modest proposal in 1929 also being abandoned; Giblin (1951, p 57).
43 *Hansard*, 26 July 1923, p 1654.

fear of unemployment due to causes entirely beyond their control, and finally the fear of a destitute old age after a life of toil'.[44]

Page and Bruce therefore announced a royal commission of senators and members chaired by Senator Millen into a national insurance scheme which would cover maternity, sickness and invalidity. The commission reported in four stages from 1925 to 1927 and an actuarial advisory committee in 1928. Page introduced the National Insurance Bill in September 1928, which proposed sickness, old age, disability and maternity benefits, generally of a pound per week, paid for by compulsory contributions of 1/- (10 cents) a week for men and 6d (5 cents) a week for women with equal contributions from employers. It also included smaller payments to parents of children under 16 and to orphans. Page appeared genuinely enthusiastic about the scheme, and it was heavily promoted during the 1928 election campaign. However it was not an enthusiasm shared by all other members of the Government.[45] The Bill had not been passed when the Government was defeated at the polls.

Other aspects

When Nationalist urban interests would not agree to tariff cuts, Page sought subsidies and export bounties for rural producers. He purportedly coined the oxymoron 'protection all round' to describe this policy.[46]

Under Page as Treasurer and Bruce as prime minister, Treasury's influence was enhanced. Treasury officials had proposed a change to cabinet procedures so that 'the [Cabinet] Secretary will not place questions on the list of waiting subjects until they have been discussed in their financial aspects between the Department and the Treasury'. Bruce softened the stance to 'it would greatly facilitate Cabinet business if, before submitting questions for Cabinet decision, they have been discussed between the Department concerned and the Treasury'.[47]

However, Bruce's decision in 1929 to establish an Economic Research Bureau within his own department could be interpreted as suggesting 'Treasury was viewed not as a policy-making body but as an agency to manage the accounts'.[48]

While attending the 1926 Imperial Conference in London, Bruce heard criticism of Australia's heavy borrowing. In the hope of boosting confidence in Australia's economic prospects, Bruce organised a delegation of leading British industrialists, the British Economic Mission, to visit Australia, but by the time they arrived in

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44 *Hansard*, 26 July 1923, p 1653.
45 Kewley (1973, pp 145-6).
46 Banks (1998, p 150).
47 Cited by Weller (2007, p 55).
48 Marshall (1987, p 404).

September 1928 the domestic economy was deteriorating.[49] Their report was critical of government enterprises, tariffs, arbitration and patterns of settlement.[50]

A National Debt Sinking Fund was established in 1923 and from 1924 half of the Commonwealth Bank's profit was paid into it.

Subsequent career

The government was defeated at the 1929 election. In some ways it may have been a blessing for Page as it spared him being treasurer when the Wall Street crash occurred a few days later. Page continued to lead the Country Party in opposition. In 1931 Lyons led the United Australia Party (UAP), an amalgam of the Nationalists and some Labor renegades, to victory. Negotiations for a coalition with the Country Party failed, notwithstanding a supposed pre-election pact. When the UAP lost seats at the 1934 election and Lyons needed Country Party support, Page again became deputy prime minister. He was minister for commerce from 1934 to 1939 and from 1937 to 1939 also minister for health. In 1938 he was knighted. As Lyons's health deteriorated, Page often had to lead the government. In one stint as acting prime minister he attempted to assemble an advisory committee to plan finance and development in the coming decade in the prospect of a war but it came to naught.[51]

Despite having tried to introduce a national insurance scheme as treasurer, and calling for it in his 1934 policy speech, with ramping up defence spending now seen as a greater priority, Page opposed the government's national insurance scheme in February 1939.[52] The scheme was abandoned, and Menzies resigned from Cabinet ostensibly in protest. When Lyons had died soon after Menzies's resignation, there was no clear successor. Page served as a caretaker prime minister from 7 to 26 April 1939.[53]

Page attacked Menzies in the House, hoping to prevent him becoming prime minister, and secure the position for Bruce to return. After criticism from within the Country Party, Page stood down as leader in September 1939. Page returned to the ministry in October 1940 as minister for commerce. Between September 1941 and June 1942 Page served as special envoy to the British war cabinet. By the time he returned the coalition was in opposition. In 1945 he took a close interest in Labor's

49 Millmow (2004, pp 148-9).
50 Melville (1929).
51 Perkins (1968, pp 65-6).
52 Martin (2003, pp 250-1). A national insurance scheme had always been more favoured by Page personally than by his party.
53 While tempted, he rejected an offer to stay as prime minister with Labor support until the next election; Page (1963, p 270).

central banking legislation and in 1949 made many speeches attacking bank nationalisation.[54]

After the coalition returned to government in 1949, Page was again minister for health. He introduced a national health plan, with various components from free school milk to subsidies for private health insurance. He became the University of New England's first chancellor and then retired to the backbench in 1956.

Ethel died in 1958 and the following year Page married Jean Thomas (Bruce was the best man), who helped him write his memoirs. Page died from cancer on 20 December 1961, unaware that the electors of Cowper had just rejected him for the first time.[55]

54 On the former, see, for example, Page's speech, *Hansard* 29 May 1945, pp 2193-2202, and Chifley to Page, 23 July 1945, Page papers NLA MS1633/346.

55 The successful Labor candidate had been brought into the world in 1909 by Dr Page; *Daily Mirror*, 23 August 1967, p 38.

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What's new on the Treasury website

The Treasury's website, www.treasury.gov.au, includes past issues of the *Economic Roundup*. Some of the other items posted on the website since the previous issue of *Roundup* that may be of interest to readers are listed in the following section.

Budget Statements

http://www.budget.gov.au/2009-10/content/myefo/html/index.htm

Mid-Year Economic and Fiscal Outlook 2009-10 (November 2009)

The *Mid-Year Economic and Fiscal Outlook 2009-10* (MYEFO) has been prepared in accordance with the *Charter of Budget Honesty Act 1998*. The Charter requires that the Government provide a mid-year budget report which provides updated information to allow the assessment of the Government's fiscal performance against its fiscal strategy.

Annual Report

Treasury Annual Report 2008-09 (October 2009)

http://www.treasury.gov.au/contentitem.asp?NavId=036&ContentID=1649

The *Treasury Annual Report 2008-09* outlines performance against outcomes, outputs and performance information contained in the Portfolio Budget Statements 2008-09.

The 2008-09 annual report includes the reporting requirements and financial accounts for the Australian Government Actuary and the Foreign Investment Review Board. The financial accounts for the Financial Reporting Panel and the Takeovers Panel are included in this report; however, the performance reporting does not extend to the activities of the Financial Reporting Panel or the Takeovers Panel as they publish their own annual reports.

Publications

Consumer Rights — CCAAC Report on Statutory Implied Conditions and Warranties

http://www.treasury.gov.au/contentitem.asp?NavId=035&ContentID=1682

On 30 October 2009 the Commonwealth Consumer Affairs Advisory Council (CCAAC) presented the Minister for Competition Policy and Consumer Affairs, the Hon Dr Craig Emerson MP, with its report *Consumer rights: Reforming statutory implied conditions and warranties*.

The report is result of a review of statutory implied conditions and warranties announced by the Government on 12 March 2009. CCAAC engaged in an extensive public consultation process in developing its report.

Terrorism Insurance Act Review: 2009

http://www.treasury.gov.au/contentitem.asp?NavId=035&ContentID=1640

The Australian Government established a terrorism insurance scheme to minimise the wider economic impacts that flowed from the withdrawal of terrorism insurance in the wake of the terrorist attacks in the United States of America on 11 September 2001. Australia's terrorism insurance scheme commenced on 1 July 2003.

The Treasurer released a report on the *Terrorism Insurance Act 2003* (the Act) in October 2009. The report meets the statutory requirement that a review is completed every three years. The report reviews the need for the Act to continue operating and recommends refinements to the scheme established under the Act. The Australian Government has agreed to all of the report's recommendations.

Consultations

http://www.treasury.gov.au/content/consultations.asp?ContentID=1013&titl=Reviews,%20Inquiries%20%26%20Consultations

Treasury conducts many consultations on behalf of the Government. The following consultations are open for public comment:

- Improving Australia's Corporate Reporting Framework
- Reforms to the Supervision of Australia's Financial Markets — Exposure Draft and Consultation Paper
- GST Administration — External Territory Tourist Refund Scheme: Exposure Draft Regulations and Explanatory Statement
- Greater Certainty for Sovereign Investments
- Exposure Draft — Minor Amendments to Tax Laws
- Issues Paper — Unconscionable Conduct
- Superannuation Clearing House — Exposure Draft of Legislation and Associated Explanatory Material
- Options to Address Fraudulent Phoenix Activity
- Income Tax Law Rewrites: Exposure Draft Legislation and Explanatory Material
- Improving Protections for Corporate Whistleblowers: Options Paper
- Review of Australia's Superannuation System

Sources of economic data

The following table provides sources for key economic data. Australian Bureau of Statistics (ABS) data can be obtained over the internet at http://www.abs.gov.au. The Reserve Bank of Australia information is available at http://www.rba.gov.au. Similarly, OECD information is available at http://www.oecd.org. Information on individual economies is also available via the IMF at http://www.imf.org.

International economy	
Output, current account balance, interest rates and consumer price inflation	OECD Main Economic Indicators
National accounts	
Components of GDP, contributions to change in GDP	ABS cat. no. 5206.0
Incomes, costs and prices	
Real household income	ABS cat. nos. 5204.0 and 5206.0
Wages, labour costs and company income	ABS cat. nos. 5204.0, 5206.0, 5676.0 and 6345.0
Prices	ABS cat. nos. 6401.0 and 5206.0
Labour market	ABS cat. no. 6202.0
External sector	
Australia's current account, external liabilities and income flows	ABS cat. nos. 5368.0, 5302.0 and 5206.0

Past editions of *Economic Roundup*

A full index to articles published in *Economic Roundup* was included in the Spring 2006 edition. Details of articles published in recent editions are listed below:

Copies of these articles are available from the Treasury. Written requests should be sent to Manager, Domestic Economy Division, The Treasury, Langton Crescent, Parkes, ACT, 2600. Telephone requests should be directed to Mr Chris McLennan on 02 6263 2756. Copies may be downloaded from the Treasury web site http://www.treasury.gov.au.