

## **The Whitlam legacy (adjusted for inflation)**

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*Brian Toohey puts the reputation of a profligate government into historical perspective.*

Soon after the December 2, 1972 election of the first federal Labor government in 23 years, the then head of the Treasury, Sir Frederick Wheeler, was sitting opposite the new Prime Minister, Gough Whitlam, at a heavy wooden table in a meeting room in the old Parliament House. Folding his arms across his chest and rocking back in his chair, Wheeler looked at the ceiling as he spoke. What the PM needed to understand, he said in a gently chiding voice, was that the nation could not afford the \$1.50 rise in the age pension promised in Labor's policy speech.

Whitlam had great respect for traditional public servants, especially those with a knighthood. He also admired a touch of arrogance in others. But Wheeler's posture and message was too much. Whitlam's fist came crashing down. The table jumped, as did an instantly silent Wheeler. "We have not spent 23 fucking years out of government," Whitlam snarled, "to be told that one of the first things I must do is break my election promise to pensioners."

The incident can be seen as an early indicator of the profligacy for which the Whitlam government became renowned. However, like so much else that occurred in Whitlam's tumultuous term as prime minister, the \$1.50 pension rise was a reform that has endured. At the time of Wheeler's objection, the age pension was equal to 19.5 per cent of average weekly earnings. The \$1.50 increase was to be the first step in taking the pension to 25 per cent of AWE. Whitlam did not fully achieve his goal. But John Howard's Coalition government has enshrined the 25 per cent figure in law.

The Whitlam legacy is even more pronounced in non-economic areas. Imperial honours and appeals to the Privy Council were scrapped. No-fault divorce was introduced. The bureaucracy was made more transparent through freedom of information and administrative appeals processes. Initial steps were taken to recognise Aboriginal land rights and to prevent racial and sexual discrimination. Equal pay for equal work was adopted. Medibank (now called Medicare) provided comprehensive health insurance. Single-parent benefits were introduced, along with support for child care. Access to tertiary education was greatly expanded. Funding for private schools increased strongly.

Diplomatic recognition was extended to China. Backing for white supremacist regimes in southern Africa was withdrawn and independence granted to Papua New Guinea. Support for the Vietnam War ceased and conscription was abolished. The first steps were taken to put the intelligence services on a proper legal basis. In contrast, however, to his normal championing of decolonisation, Whitlam failed to discourage the 1975 invasion of East Timor thus establishing a policy position which

was reversed only amid the bloodshed accompanying the August 1999 independence ballot.

In other areas, such as support for the film industry and the easing of censorship, Whitlam has received the credit for changes that really began under John Gorton. And although Whitlam likes to hog the applause, the dismantling of the White Australia policy really began under Harold Holt.

As a result, it is too simplistic to divide postwar Australian politics into pre-Whitlam and post-Whitlam eras, with Whitlam trying to overthrow everything that went before him and all subsequent governments (especially Labor ones) determined to distinguish themselves from Whitlam.

Admittedly, a major ideological shift in favour of free markets followed Whitlam's time in office. But it was encouraged primarily by the global reaction to the "stagflation" (a combination of rising unemployment and inflation) that accompanied sharp price rises initiated in 1973 by OPEC. If anything, Whitlam was more willing to contemplate an economic reform agenda than the Liberals' most electorally successful prime minister, Robert Menzies.

Whitlam cut tariffs by 25 per cent across the board, abolished a range of industry hand-outs such as the superphosphate bounty and established the first budget "razor gang" (even if the savings were rapidly dissipated). Corporatisation ensured phone and postal services were no longer delivered by a government department, the Postmaster-General's.

Within the first month of being elected, Whitlam revalued the Australian dollar by 7.05 per cent to correct the downward bias allegedly injected by Country Party ministers in the Coalition. If the idea had been part of the mainstream debate at the time, Whitlam would probably have considered floating the dollar (against Treasury advice).

None of this is to say that Whitlam was not a bad economic manager. He was. But he also confronted more perplexing economic problems than Menzies. He shared Menzies' lack of interest in economics without enjoying Menzies' good luck in being able to rely on advisers whose management techniques worked.

Despite all the alleged structural rigidities, the outcomes under Menzies were good. Overall growth was strong. Unemployment from 1945 until 1973 averaged well below 2.0 per cent. Interest rates were low and inflation normally under control, even though it peaked briefly at 22.2 per cent during the 1952 Korean wool boom. On that occasion, it was swiftly brought under control through a combination of tough monetary policy and an end to the Korean War. When inflation threatened again in 1960, the Menzies government responded with a credit squeeze (and nearly lost the 1961 election).

In other words, inflation was attacked with the standard Keynesian demand management tool on the monetary policy side. It worked. Recessions never threatened to the extent that a deliberate resort to deficit budgets was required.

Menzies gave no hint that he was in any way disconcerted by the fact that he was relying on a Keynesian approach later lambasted as ideologically impure. In his memoir *Afternoon Light*, Menzies stressed that he opposed a doctrinaire approach to the economy. He dismissed "wage slashing" and strongly supported a role for governments in preventing a return to large-scale unemployment.

In a famous 1942 radio talk, he said he did not want to return to "the old and selfish notion of laissez-faire. The function of the state will be much more than merely keeping the ring in which the competitors will fight". During the same talk, he denounced the "fabulous sums" paid to "beautiful halfwits" in the movies and praised universities for inculcating "values which are other than pecuniary". In government, he left a top marginal tax rate of more than 80 per cent in place for several years.

Menzies' most distinguishing feature was that he was simply not interested in the conduct of economic policy. His long-serving Treasurer, Arthur Fadden, rates a few brief mentions in *Afternoon Light*, but never in the context of economic policy. A single sentence is devoted to his trade minister, John McEwen. The mention, ironically, would have endeared him to those protesting today against the World Trade Organisation. In spite of his government's protectionist reputation, Menzies wrote that McEwen was fighting against a trade system that endangered international peace by allegedly widening the gap between rich and poor nations.

Whitlam proceeded on the basis that he would inherit Menzies' good fortune and could rely on continued growth to fund his programs. What changed was that OPEC triggered a bout of "cost-push" inflation which coincided with rising unemployment, rather than the more familiar "demand-pull" experience in which employment rose with prices.

Although ministers such as Jim McClelland took the problem seriously, OPEC's effect on Australia was reinforced by sharp rises in wages. Whitlam's instinctive response was to blame the then ACTU president, Bob Hawke, for not exercising more restraint. Inflation peaked at 17.5 per cent in the March quarter of 1975. This was not as bad as the 27 per cent experienced in the UK or 26 per cent in Japan. But it was bad enough to do severe political damage.

Just as harmful was the rise in unemployment to a peak of 4.5 per cent by the time of Whitlam's landslide electoral loss in December 1975. The figure is well short of the 11.3 per cent reached as a result of the 1990-91 recession which was exacerbated by the failure of economic management during Paul Keating's stint as Treasurer. In 1975, however, a 4.6 per cent unemployment rate was electoral poison among voters accustomed to a rate below 2.0 per cent.

The Whitlam government responded to rising unemployment with increased spending, partly funded by budget deficits. A strong case exists that the increases were so steep as to involve significant waste and severe economic dislocation. At least in direction, however, it was still an orthodox policy reaction during an era in which the then US president, Richard Nixon, had announced "we are all Keynesians now".

But Whitlam also responded to rising inflation with the standard Keynesian technique of tightening monetary policy soon after the 1973 OPEC price shock began to bite. Interest rates on 90-day bank bills more than doubled over the course of 1973-74 to 11.3 per cent.

In a less orthodox response, Whitlam also followed Treasury advice in setting the exchange rate at artificially high levels in an effort to bear down on prices. As a result, the exchange rate in August 1974 was a punishing 120.5 points on a trade-weighted basis. After the switch to a floating rate, the Australian dollar now is valued at less than half the level Whitlam was advised to impose in the name of fighting inflation. Although Whitlam may not have appreciated the point, economic policy was pulling in two contrary directions. He was trying to combat rising

unemployment with expansionary spending, while tackling inflation with contractionary rises in interest and exchange rates.

The budget deficit peaked at 2.0 per cent of GDP in 1975-76. This was not as large as the 1983-84 deficit of 3.4 per cent, nor the 1992-93 deficit of 4 per cent, each triggered by a recession. However, Whitlam's deficit was enough to propel the issue of responsible economic management to the forefront of Australian politics for the next quarter of a century.

In the place of Keynes, two new gurus arose. One, Friedrich von Hayek, gave general philosophical support to the notion that free markets, and small governments, underpin political liberty. The other, Milton Friedman, provided a precise technique for allegedly controlling inflation by controlling the money supply. Reducing the growth of the latter was taken to be synonymous with reducing budget deficits.

The incoming Liberal Treasurer after the December 1975 election, Philip Lynch, adopted Friedman's doctrine as official government policy. The new Labor treasurer in 1983, Keating, gave an explicit commitment to continue with this Friedmanite doctrine after the landmark float of the Australian dollar in 1983.

In 1985, the policy was quietly dropped for the simple reason that it had proved impossible to control the money supply, let alone establish any worthwhile connection with the control of inflation. The reason should have been obvious from the start. The equation relied on by Friedman contained too many variables for one (prices) to move in lock-step with another (the money supply). The ignominious abandonment of his core policy prescription was barely noticed. Those who'd earlier embraced it with misplaced fervour continued to present themselves as exemplars of what it meant to be economically literate and numerate.

But the post-Whitlam preoccupation with budget deficits remained. Soon Treasury was promoting an equation purporting to demonstrate a decisive link between budget deficits and the size of the current account deficit on the balance of payments. The distinguished economist and bureaucrat Michael Keating noted that the so-called "twin deficits" theory was based on the same sort of algebraic nonsense as Friedman's money-supply equation. Nevertheless, Treasury officials continued to espouse the theory as if it were an unassailable truth long after it was shown to be clearly flawed at both a theoretical and an empirical level.

The Hawke-Keating Labor governments won widespread plaudits for liberating product and financial markets. Unhappily for Labor, however, Keating was still running a budget deficit generated by the 1990-91 recession at the time of his smashing electoral defeat in 1996. Although the deficit was relatively small and declining his finance minister, Kim Beazley, copped the political flak after taking over as Opposition Leader. The Liberal's Treasurer, Peter Costello, did a superb political job of constantly reminding voters of the deficit he dubbed "Beazley's black hole".

By 2000-01, Costello himself was running a small deficit, despite being the beneficiary of a long period of strong economic growth. This time the deficit barely caused a ripple. In some ways, the subdued reaction may signal that the political potency of budget deficits as a symbol of Whitlamite "excess" may be fading at least for the Coalition.

A case can be made that the Howard-Costello government has not exercised strong discipline over spending. Although few seem to be listening, Labor keeps complaining that Howard is running a "big taxing, big spending" government.

The argument is based on the proposition accepted by the Australian Bureau of Statistics and the Australian National Audit Office that the GST is really a Commonwealth tax. Once the GST is treated as funding Commonwealth payments to the states and after allowing for the removal of other state taxes the Howard government can be seen as being in the same spending league as the Whitlam government.

According to HSBC's chief economist, John Edwards, adjusting for the GST factor means that the Howard government's spending in the current year is 25.2 per cent of GDP, compared to 25.1 per cent for Whitlam. Treating the GST as a Commonwealth tax means revenue collected by Howard amounts to 25.5 per cent of GDP, compared to 23.5 per cent under Whitlam. Fortunately for Howard, the official budget figures are 2.5 percentage points lower than this.

In any event, voters don't appear too bothered. For Howard, economic management has receded into the background as an electoral issue in much the same way as happened under Menzies. Like Menzies, Howard can now concentrate on national security issues while promoting conservative social values. The parallels are by no means exact. For example, the problem of salinity, which Howard wants to address, was not on the agenda for Menzies. Overall, however, Howard is in the same enviable position as Menzies in being able to concentrate on non-economic issues that resonate with the voters. It is really only Labor that does not enjoy that luxury today. Unlike Howard, Labor is yet to break free of the Whitlam legacy which requires political parties to constantly demonstrate their credentials as sound economic managers.