FROM FEAR OF DEPRESSION TO FEAR OF WAR: A REINTERPRETATION OF THE POLITICAL ISSUES INVOLVED IN THE TRANSITION FROM THE CHIFLEY GOVERNMENT TO THE MENZIES GOVERNMENT, 1945-1952

by

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A thesis submitted for the degree of Doctor of Philosophy of The Australian National University.
Declaration

This thesis is my own work.

[Signature]

DAVID LEE
Preface and Acknowledgements

While preparing this thesis over the past few years, I have become indebted to many individuals. Greg Pemberton, Chris Waters, and Chris Goscha offered me many helpful suggestions and guided me to sources in the labyrinth of the Australian Archives. Barry Smith, Cameron Hazlehurst, Ken Inglis, Neville Cain, and Selwyn Cornish read and commented on several draft chapters. My mother and father assisted with proof reading. And Toni Makkai gave me valuable help with word processing.

My greatest debt of all is to Dr A.W. Martin for patient and encouraging supervision of all the drafts leading up to the final manuscript. Needless to say, none of those mentioned above are responsible for the arguments made in this thesis.

Throughout this thesis I have adopted the principle of capitalising only proper names and names of countries and individuals.

While I was researching and writing this thesis several books which covered aspects of my topic were published — books such as Tom Sheridan's discussion of industrial relations in the Chifley years, and Geoffrey Bolton's general history of Australia from 1942 to 1988. I have taken into account all these books except Philip Dorling's *The Origins of the ANZUS Treaty: A Reconsideration*, a Flinders Political Monograph. Unfortunately this monograph only became available towards the end of 1990 when my research and writing had largely been completed.
In this thesis I attempt to trace the most important differences between the Chifley and Menzies governments. Without disagreeing with the view that the two governments agreed on many things, such as the need for a large immigration programme, Keynesian economic ideas, and the welfare state, I argue that there was a fundamental difference between the two governments: their attitudes and policies to the threats of depression and war. A Labor government afraid of depression but relatively confident that another war would not break out, gave way to a Liberal-Country party government which feared the outbreak of war but not a depression.

The Labor government hoped to protect Australia from depression by participating in the new economic world order being built by the United States after the second world war. However it tried to mould the American multilateral system into one which would guarantee full employment throughout the world. America's idea of free trade defeated Australia's idea of full employment in the making of the new economic world order. But multilateralism foundered because of the dollar shortage in the world outside the United States. The United States wanted to dismantle the sterling area and to incorporate it immediately into the multilateral world order. However the United Kingdom found that she could not adopt multilateralism without massive foreign aid from the United States. Instead of embracing multilateralism, the United Kingdom resolved to shore up the sterling area, until some means of overcoming the dollar shortage could be found. The Australian Labor government resolved to cooperate with the United Kingdom in consolidating the sterling area as a discriminatory economic bloc. Chifley made a deliberate decision to stick with the United Kingdom rather than to seek a stronger economic relationship with the United States.

The opposition Liberal and Country parties chafed at the restrictions and rationing caused by the Labor government's pro-sterling area economic policies. They
defeated the Labor government in 1949 by campaigning against its policy on the sterling-dollar problem, its domestic economic policy, its handling of the coal strike, and bank nationalisation. The issue of socialism was largely rhetorical. The fundamental difference between the two governments was not about the degree of government ownership of industry and banking. The Menzies' government's major new initiative was to make serious defence preparations against the danger of war. It abandoned Labor's internationalist foreign policy and regional defence policy and substituted for them a policy of making Australia a partner in the western anti-communist alliance being formed against the Soviet Union and the emergent communist China.

Menzies expanded defence spending along with public and private investment in a policy of 'national development'. This was in stark contrast to Chifley's fiscally cautious anti-depression economic policy. It involved running a huge import surplus at a time when the sterling-dollar problem was still serious and when Australia was vulnerable to an economic downturn. Fortunately for Menzies, American rearmament, the Korean war wool boom, and a dollar loan from the United States temporarily solved the dollar problem for Australia and the sterling area. Menzies succeeded in being able to have both increased defence expenditure and increased civilian investment. Moreover the Menzies government decided that Australia could not be developed at the rate it wanted simply with British and Australian capital. Its policy was that Australia had to forge a new political and economic relationship with the United States. The Liberal-Country party government hoped that this policy would free up the economy, enable Australia to borrow from America, increase the flow of American capital into Australia, and allow the government to abolish the controls and restrictions associated with Labor's policy of protecting the sterling area.
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INTRODUCTION

The Chifley government’s defeat in December 1949 was regarded by contemporaries as a watershed. They saw Menzies’ election as a triumph for ‘liberal capitalism’ and a rejection of ‘socialism’. Historians looking back on the transition from Chifley to Menzies are inclined to disagree with the contemporary view. In the fifth volume of the *Oxford History of Australia, 1942 – 1988*, Geoffrey Bolton argues that the continuities before and after the 1949 election were greater than the changes. Bolton seeks to explain why the Labor governments of Curtin and Chifley, which were so constructive in their purposes, failed to endure after 1949. He does not see the answer in the contrast between the coalition’s free enterprise doctrines and the Labor governments’ interventionism, since the Menzies government was no less interventionist than its predecessors. Keynesian thought continued to guide the economic policy of the Menzies government, social welfare was maintained, the immigration programme continued, and the arbitration system was retained as the proper arena for resolving industrial disputes. The one significant division between Labor and the coalition was the issue of communism, but this was ‘largely a dispute about rhetoric and tactics rather than an indication of strong disagreement about the ultimate validity of Australian capitalism.’

Revisionist critics of the left arrived from different angles at the conclusion that there was not much difference between the Labor government and its opponents, except in the realm of rhetoric. Rob Watts has argued that Labor’s welfare state had its origins in the planning of the United Australia Party government, and that it was a quid pro quo for the need of the wartime governments to gain more revenue by taxing the incomes of the working classes. Beresford and Kerr have argued that the Labor government initiated a break in the economic relationship between Australia and the

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United Kingdom, by surrendering to the new economic hegemony of the United States.\(^3\) And Tom Sheridan has argued that the Chifley government ruthlessly exploited the machinery of government in order to clamp down on the legitimate wage demands of trade unions in order to control inflation.\(^4\)

Political scientists also debate with each other about whether there were real ideological differences between the two major political groupings which formed governments. Peter Tiver was exceptional among political scientists in arguing that the Liberal party had a distinct political ideology. He saw Liberal ideology as an interaction between individualist and ameliorative tendencies. He viewed individualism as the product of the laissez faire views of businessmen, lawyers, and graziers. He regarded the ameliorative tendency in Liberal ideology, usually reduced to welfarism and social policy, as the response of the party’s parliamentary and administrative leaders to the needs of electoral success.\(^5\) Marian Simms and Kosmas Tsokhas criticized Tiver’s argument on the ground that he perceived ideology in terms of a conglomeration of ambiguous, contradictory, and disconnected values, beliefs, symbols, and dispositions. They argued that both Labor and non-Labor were interventionist. But the Liberals were constantly trying to reconcile the anti socialist free enterprise ethos, which featured in the rhetoric of their election campaigns, with the actual, activist role of the state sector in the economy. Both political groupings shared the same ends, but differed over means.\(^6\)

This thesis sets out to make a broad assessment of what the transition from Chifley to Menzies meant: whether it was a significant turning point or no turning point at all. Without disagreeing with Bolton’s argument that there was continuity in

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\(^4\) Tom Sheridan, Division of Labour - Industrial Relations in the Chifley Years, Melbourne, 1989.


many things between the two governments, it seeks to find the most significant policy
differences between the two governments. I argue that the major policy difference
between the Chifley and Menzies governments was not the issue of 'socialism' as it
referred to government ownership of industry and banks. The difference was between
a Labor government whose policies were primarily concerned with the need to make
Australia secure against depression, and a coalition government which was concerned
to prepare for war, to make Australia an effective participant in the anti-communist
western alliance being formed against the Soviet Union and its allies, and to speed up
the pace of Australia's development. The Labor government maintained an
independent and internationalist stance in foreign policy and a strongly pro-British
Commonwealth stance in economic policy. The coalition government reversed
Australia's independent stance in foreign policy and sought to bring Australia into line
with British and American cold war policies. Moreover, impatient with Australia's
dependence on an economically weak British Commonwealth, the Menzies government
took steps to reorient Australia's economy towards the United States. Thus while there
was too much continuity between the two governments to justify calling the 1949
election a watershed, there were significant differences that made the 1949 election a
turning point in the political history of the Commonwealth of Australia.

The difference between the ideologies of the Chifley and Menzies governments
was not 'interventionism' versus 'laissez faire', since both governments were
interventionist. But the two governments differed fundamentally over the purpose of
interventionism. For Labor, government intervention in the economy was necessary in
order to preserve full employment. For the coalition government, economic controls
were necessary to reconcile the competing demands of the need to develop Australia's
economy and the policy at the same time of increasing preparations for defence. For
Labor, import restrictions and rationing were necessary to protect the sterling area as
a bulwark against the dollar shortage and against the possibility of depression
spreading from America. The coalition parties disliked discrimination against the
United States and restricted access to American goods. They retreated from the restrictions and rationing involved in a too close dependence on the sterling area but nevertheless had to reintroduce import restrictions in 1952 in order to protect Australia’s overall balance of payments. This was an inevitable consequence of the Menzies government’s ambitious defence and development programmes.

Australia had been a member of the sterling area since the great depression. This was an economic unit comprising all the sterling countries in the British Commonwealth. Its origins went back to the 1930s when the United Kingdom went off the gold standard and floated her currency. Moving off the gold standard had the effect that the pound sterling would float up and down in a way that was alarming for countries like Australia whose economies were closely linked with Britain’s. The sterling Commonwealth nations and a number of non-Commonwealth countries formed a ‘sterling area’, where currencies remained fixed in value to one another although they floated against non-sterling currencies. The British government acted as banker to the sterling area, held the free reserves of the other members of the sterling area, smoothed the fluctuations of sterling in a world of abrupt changes in value, and allowed members of the group the opportunity to raise loans in London. In Ottawa in 1932 the United Kingdom and the dominions agreed on a system of imperial preference whereby the United Kingdom gave preference to the agricultural products of the dominions in return for the dominions replacing some of the industrial goods they bought from foreigners with British products. After the outbreak of war, the sterling area was legally defined for the first time in United Kingdom exchange control regulations. The sterling area mobilized the means of purchasing outside the sterling bloc, particularly dollars, for the prosecution of the war. After the war the sterling area became a system of cooperative exchange and import controls, restricting transactions with non-sterling countries, but allowing complete freedom of payments among members. Member countries agreed to sell dollars to Britain in exchange for
sterling. They controlled dollar expenditure through import licensing systems, with a severity governed by the state of the sterling area's common reserves.

The change in policy concerning the sterling area—from Chifley's protection of the sterling area to Menzies' retreat from it—was one of the most important issues in the transition from Chifley to Menzies. Protection of the sterling area was motivated by fear of depression. The retreat from the sterling area resulted from Menzies' need to obtain capital from outside the sterling area, particularly from North America, for his defence and development programmes. The other main issue involved in the transition was the respective governments' attitude to war. The Chifley government was wedded to the idea of liberal internationalism—the arbitration of the United Nations on disputes between countries. Defence policy was based on an idea of collective security where Australia would have responsibility for the defence of the Pacific. The coalition parties had no faith that the United Nations would make Australia secure. They abandoned Evatt's internationalist foreign policy, stepped up Australia's defence spending, and threw off Labor's localized defence policy. Australian defence policy would no longer be based on the defence of Australia and the islands placed under its authority. It would be based on the strategy of fighting the communist enemy where the Americans and the British deemed that Australia could make the best contribution. Australia would turn away from the United Nations and look to its great allies, and particularly the United States, for security. Economically, Australia would throw off its dependence on the sterling area in favour of a stronger relationship with the United States.

The transition from Chifley to Menzies was therefore a significant turning point in Australian history: a change from a government fearful of depression to a government fearful of war.
CHAPTER ONE - THE SEARCH FOR SECURITY AGAINST DEPRESSION THROUGH INTERNATIONAL COLLABORATION*

The main objective of the reconstruction programme of the Chifley government was to safeguard Australia against depression. The Labor government developed a detailed domestic full employment policy in the white paper of 1945. It realised, however, that because the Australian economy was particularly dependent on trade, full employment could only be achieved by the expansion of world trade and employment.1 In this chapter I examine how the Chifley government, and its predecessor, sought to secure Australia's full employment and development programmes in a changing international environment where British economic power was waning and where the United States was trying to impose the ideology of multilateralism on the rest of the world. The Labor government decided that the best hope of avoiding depression was by international collaboration and by moulding the American doctrine of multilateralism into an international commitment to full employment. The opposition Liberal and Country parties were originally vehemently critical of Labor's support of multilateralism, which they regarded as a threat to greater British Commonwealth unity. Unfortunately for the Chifley government, the Americans resisted attempts to convert multilateralism into a programme of full employment and world economic reconstruction. And because of this, their policy originally failed. By the end of 1947, multilateralism was in tatters: depression and economic chaos seemed imminent. The Chifley government retreated from the objective of multilateralism, eschewed building a new economic relationship with the powerful and dynamic American economy,


and strengthened Australia’s traditional association with the United Kingdom and sterling. This policy sowed the seeds of the Labor government’s destruction in 1949.

Multilateralism was a policy which embraced the notions of nondiscriminatory trade, currency convertibility, and the equal access of nations to raw materials. It was developed by secretary of state Cordell Hull in the second world war. The United States government made the British government accept the principle of multilateralism in return for providing them with aid under lend-lease. It also asked the Pacific dominions, Australia and New Zealand, to accept a commitment to multilateralism by signing article VII of the mutual aid agreement. This clause committed both countries to participate in international bargaining leading to tariff reductions after the war. Some historians interpret multilateralism as an altruistic programme designed to reverse interwar economic nationalism and to rebuild a productive and efficient international economy.2 The revisionist school of American diplomatic history, however, argues that multilateralism was a tool designed to establish American hegemony in the postwar world: an ‘open door’ strategy to enable the United States to dominate global trade, resources, and investment.3 The response of the Australian Labor governments to multilateralism has also been a subject for debate. On the one hand, Roger Bell has argued that the Australian government was unwilling, in the war years, to accept a commitment to reduce tariffs and other discriminatory arrangements in world trade.4 Indeed Bell


has argued that the wartime Labor governments viewed multilateralism as a subtle form of economic imperialism and that Australia's full employment policy was, at least in part, a device to counter the American doctrine. C.B. Schedvin, on the other hand, has countered that the Australian wartime governments decided that Australia had more to gain from the policy of multilateralism than she did by preserving the system of imperial preference. My argument is that although the Labor governments preferred multilateralism over economic nationalism, they did not want international collaboration in the American form. They tried to mould the American policy into an international commitment to full employment backed by the might of America's economic resources.

During the second world war there was a vigorous debate within the Australian government, parliament, and bureaucracy about the merits of multilateralism. The view eventually adopted by the Labor government was that of an interdepartmental committee on external relations of 20 August 1942. The committee saw multilateralism as having two aims: first to increase production, employment, consumption and world trade; and secondly to eliminate barriers to trade and discrimination in trade. It noted:

The root of the matter must be the increase in production and employment, from which will flow improved consumption and the extension of international trade, which will further raise consumption standards. The removal of trade barriers should accompany and fortify them. It is important then that positive measures to increase productivity should figure largely in any plan to promote world prosperity.

The Australian Labor government tended to view the expansion of world trade and employment as the primary aim of international collaboration, whereas the

Americans regarded the abolition of trade barriers and discrimination as the principal objective of multilateralism.7

The committee argued that, without international collaboration, Australia's economy would be vulnerable to depression. Her London funds would be low after the war, her export markets would be limited, and surpluses accumulated during the war would not be immediately marketable. Moreover Australia was already committed to making gifts to countries, particularly Britain, which were devastated by war. The committee thought it probable that her full employment programme after the second world war would involve Australia in acute balance of payments difficulties. If the principal countries of the world, and particularly the United States, adopted consistently and effectively a policy of full employment, the danger of a severe slump in Australia's export income would be much reduced. But in the absence of an assurance of this kind, difficulties over Australia's trade balance had to be expected. Without effective international collaboration to maintain full employment, Australia had three possible defences of her international solvency: exchange depreciation, the reduction of her overseas obligations - (debts, loans and gifts to other countries), and the use of exchange controls and import restrictions in conjunction with rationing. If Australia's full employment policy produced severe pressure on her London funds, the government could impose import controls and exchange restrictions to bring down imports to a level at which Australia could pay for them. The dilemma for the Labor government was that if it agreed to American style multilateralism, its ability to use these defences would be extremely limited.

It was because the Labor government wanted to be able to maintain full employment in Australia without having to restrict imports and ration goods, that

7 'Australia's position in relation to article VII of the Anglo–American mutual aid agreement', 20 August 1942, CP 43/1/1 43/444 Part 1, Australian Archives (AA).
it thought multilateralism desirable. The expansion of world trade would allow Australia to build up her overseas reserves, and international collaboration would work towards reducing depressions to manageable proportions. The committee on external relations argued: 'if we can see, by either or both of these ways, a good probability of security for our balance of payments, then we should be prepared to pay the price necessary to ensure this international collaboration' - that is by agreeing to adopt multilateralism as an Australian objective. In the Australian Labor government's opinion, international collaboration had to include positive action: both internal action by all countries to maintain full employment, and external help provided by the strong countries to the weak. As the strongest nation after the war, the United States would have to provide assistance to the rest of the world in the form of government gifts, private gifts, government loans, and private investment. The United States would probably go some way towards making gifts and loans to other countries, if only to find a market for her surplus postwar production. But if the United States tried to keep an excess of exports over imports, the whole system of international collaboration would break down. The fundamental problem with the Chifley government's economic policy after the war was that the United States kept up a huge export surplus and, because of this, the system of international collaboration threatened to break down.

Leslie Melville, a member of the government's financial and economic advisory committee (F & E) reported that the government had found severe difficulties in defining its attitude to article VII. Melville himself thought that the American objective of international economic liberalism was incompatible with the Australian objective of full employment. He wrote:

The loss of welfare resulting from barriers to trade is not nearly as great as that which will result from the instability which seems to be the

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8 The idea of America actually giving away her export surplus was suggested by Herbert Feis, economic adviser to the state department, in 'Restoring Trade After the War', *Foreign Affairs*, January 1942.
inevitable accompaniment of the liberal internationalism which the clearing union and tariff negotiations seek to restore.  

Despite such dissenting opinions as Melville’s, the Australian government agreed that article VII should provide the general basis of the postwar economic order provided that the relaxation of trade barriers contemplated under article VII was facilitated by the positive aims of collaboration. In simple terms, Australia would agree to reduce barriers to trade if the Americans would contribute positively to international economic reconstruction and to the maintenance of full employment.  

The Chifley Government and the American Loan  

The Americans sought to attain their objective of multilateralism through three main instruments: by establishing an international clearing union for international currencies; by drafting a code for the regulation of world trade; and by obtaining from the United Kingdom commitments to currency convertibility and non-discrimination in return for dollar aid. After the second world war Britain required imports that cost about £1000 million annually; yet her exports had been cut so severely that they yielded a mere £400 million annually. On top of this balance of payments problem, the United Kingdom had an accumulated deficit of about £3000 million, the so called ‘sterling balances’ of wartime debts owed to countries in and outside the British Commonwealth. The only way that Britain could preserve her position as an international power, maintain a reasonable living standard for its people, and continue to act as a banker for Commonwealth countries like Australia, was to obtain a loan of about $5 billion from the United States. 


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9 ‘Article VII – letter from Melville to Giblin and memorandum on F & E difference’, CP 43/1/1 43/444 Part 1, AA.  
10 Ibid., telegram 113, Australian government to dominions office, 11 February 1942.  
For their part the Americans were determined to attach three conditions to a dollar loan to the United Kingdom. The first was that Britain should consent to reduce her tariffs, including the imperial preferences fixed at Ottawa in 1932. The second was that sterling should be made freely convertible into dollars by 1947. This meant that the Bank of England would be obliged to pay out scarce dollars for the sterling earned by Britain’s trading partners. And the third condition was that the sterling balances should be scaled down. These huge debts stood in the way of sterling-dollar convertibility and the Americans feared that the British might stagger the release of the balances in non-convertible instalments which would discriminate against the United States, establishing new, and strengthening old, trade patterns with sterling users.

The total effect of these demands would be to dismantle the sterling area and to incorporate it immediately into a multilateral system. When the Chifley government was informed about the American demands for the dissolution of the sterling area, it bitterly resisted any attempt to give the Americans concessions on imperial preference. This was not because it wanted to retain preferences, which only affected one fifth of Australian exports, but because it wanted to bargain preferences for American tariff reductions. 12 Only when all nations and particularly the United States had lowered their tariffs and agreed to maintain full employment would Australia agree to surrender her economic defences against depression. 13 The government was not as concerned with the threat to scale down Australia’s sterling balances since the British were persuading the Americans to leave the matter of their sterling debt to be settled between the United Kingdom

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12 ‘Postwar prospects for Australia’, F & E committee, n.d. 1943, CRS A989/1 43/735/51/3 AA.

and its individual creditors. As for convertibility, the Australians looked forward to a time when they could convert their sterling into dollars without restrictions.

The government disliked the idea of the United Kingdom making on imperial preference any concessions which would limit Australia's freedom of action in future tariff preference negotiations. So prime minister and treasurer Chifley cabled the British prime minister, Clement Attlee, on 23 October 1945. He argued that there were two undeniable justifications for American aid to Britain without strings: first, that Britain had exhausted herself waging war on behalf of the allies before the provision of American aid under Lend-Lease; and secondly, that American assistance would contribute substantially to the restoration of world trade, from which the United States itself would benefit. 14

Chifley argued that the United States was using the loan to force concessions on imperial preference before talks were opened up on a level which included the dominions. He doubted whether the Americans would make tariff cuts equivalent to the British Commonwealth's concessions on imperial preference and doubted also whether they appreciated that concessions on their part were 'an essential part of any programme aimed at the expansion of world trade and employment in default of which the balance of payments problem with the United States is unlikely to be solved without continuing financial aid'. He preferred the United Kingdom forfeiting the loan, if the Americans continued to be recalcitrant, rather than submitting to American demands for dismantling imperial preference without reciprocal American tariff cuts. 15

14 Cablegram, Chifley to Attlee, 23 October 1945, CP43/1 B61/1945/525 Part 2, AA.
15 Ibid. Chifley's precise words were that Attlee could 'rely on the Australian government cooperating with the United Kingdom and the rest of the sterling area in seeking an [alternative] solution and Australia would accept the disabilities that would follow a reduction in dollar imports.'
In early November, the dominions office informed the Australian government that the Americans had abandoned their extreme proposal for the immediate sweeping away of preferences. At the same time the British put up a set of counter-proposals as a first step in the gradual elimination of preference. In the view of the Americans, these counter-proposals would serve to confine and eventually eliminate the system of imperial preference. The Australian government agreed. Chifley cabled the dominions office on 13 November that the Australians could not acquiesce in the British counter-proposals. In Chifley’s view, American financial aid to Great Britain could not solve the imbalance in world trade by itself. What was needed to remedy the dollar shortage was a coordinated American programme of tariff reductions and investment abroad.

The British replied almost immediately. They argued that to seek further amendments on the imperial preference issue would lead to a ‘break’ with the Americans in the loan negotiation. In Canberra Chifley was worried. He was disturbed that the preference issue had been ‘hatched’ in negotiations at which Australia was not represented. And according to H.C. Coombs of postwar reconstruction, he disliked the whole idea of ‘appeasing the Yanks’. But he was obviously in two minds. On the one hand he thought that the Americans were imposing multilateralism on the sterling area prematurely. On the other hand, he appreciated the parlous state of the British economy and its urgent need for dollars from which the whole sterling area would benefit. He cabled the dominions office

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16 Ibid., cablegrams 2069 and 2070 from the secretary of state for dominion affairs, 5 and 6 November 1945.
17 Ibid. These were that existing arrangements with the dominions should not stand in the way of negotiated action on tariff preferences; that reductions in tariffs would automatically reduce or eliminate margins of preference; and that margins of preference were not to be increased and no new preferences introduced.
19 Ibid. Cablegram 394 from the Australian government to the dominions office, 13 November 1945.
20 Ibid., cablegram 459 from the dominions office, 13 November 1945.
on 15 November, expressing his continued objection to the British counter-proposals on preference. He wrote: 'We are firmly of the opinion that the formula represents a unilateral concession to the US in which an important matter of principle has been given away. By implication it recognizes that preferences are inherently more vicious than tariffs and therefore prejudices our power to bargain preferences against tariffs'. But in view of British advice that further requests for amendments would lead to a 'break' with the Americans, he withdrew his request that the United Kingdom dissociate itself from the preference counter-proposals.21

The British did not want to break with the Americans on preference. They submitted to the onerous American demands to make sterling convertible in 1947, to abandon discrimination, and to abolish the sterling area dollar pool. The American assistant secretary of state for economic affairs, Will Clayton, had been particularly insistent on this point, arguing that because of its potential for discrimination against American goods, 'the abolition of the dollar pool was much more important to US exporters than the elimination of empire preferences.'22 The British had managed to convince the Americans that the sterling balances should be a matter for negotiation between the United Kingdom and her individual creditors, and not unilaterally written off in accordance with American practice over Lend-Lease. The British chancellor of the exchequer, Hugh Dalton, was adamant that any arrangements concerning the sterling area, particularly regarding scaling down of debts, 'should not (repeat not) be formalized in America'; the British Labour government was anxious not to destroy the possibility of creating in the future a British Commonwealth economic bloc.23 In December the Americans tried to make it a condition of the loan that the British

21 Ibid., draft telegram for secretary of state for dominion affairs, 15 November 1945.
23 Ibid, p.84.
join the International Monetary Fund, which they were prepared to do, but also that they should forego the safeguards written into the Fund to protect British and Australian interests. Dalton wrote that this condition was completely unacceptable: ‘We had practically made up our minds, that if the Yanks refused to budge, we would break on this issue’ although the consequence for the British Commonwealth would be an ‘Irish peasant’s standard of living’. The Americans relented, allowing the British to discriminate against the dollar in certain circumstances and to withdraw from the Fund if they so wished.

In December 1945 the terms of the Anglo-American Loan Agreement were finalized. There would be a loan of $3.75 billion at three per cent interest, much less than the British wanted, and the price of the loan was British acceptance of multilateralism. The Loan Agreement placed limitations on the United Kingdom’s ability to use exchange controls to protect its balance of payments, and section nine of the agreement prevented the British from discriminating against American imports. The Americans understood that this section also applied to the dominions. In section ten of the Agreement, the United Kingdom agreed to make arrangements covering the sterling balances. And more importantly the British agreed to introduce sterling dollar convertibility twelve months after congressional ratification of the loan.

The Chifley Government and the International Monetary Fund

There were two rival plans for an international monetary fund: the American Stabilisation Fund and the British Clearing Union. The Stabilisation Fund proposed that the international reserves made available for borrowing by countries with balance of payments difficulties would be obtained from contributions of gold and local currencies of member countries. The British Clearing Union proposed that

these reserves would be provided by the creation of a new international currency, which could be transferred from one account to another in the books of the Union in settlement of payments due by members to each other. The Clearing Union also permitted much more extensive use, by countries experiencing balance of payments difficulties, of measures such as exchange and import controls, and currency devaluation.26

The total resources of the American Stabilisation Fund were limited to $5 billion, and the amount of credit which the Americans could be called upon to pay to other countries was limited to the size of its own contribution—about $2 billion. But the British Clearing Union provided overdraft facilities of $25 billion to member countries. Each member could draw a quota equivalent to its share of pre-war trade. And furthermore the liability which the Americans might be called upon to bear under the British plan was limited only by the total drawing rights of other countries—about $23 billion. The Clearing Union was clearly the better option for Australia. It was more expansionary than the American version in its effect on world economic activity, and it gave Australia greater access to international reserves than did the Stabilisation Fund.

The Labor government strongly objected to the American Stabilisation Fund because it placed no emphasis on the prevention of depression in the major economies, in the face of which the limited resources of the Stabilisation Fund would be ineffective. Moreover while the Stabilisation Fund contained provisions for the disciplining of debtor countries, it had no effective sanctions against creditors. When these objections were put to the Americans, they replied that any attempt to write into the scheme an obligation to maintain full employment, or to stop creditor nations from accumulating international balances would be

unacceptable to congress. Moreover the Americans insisted that there had to be restrictions on the right of member countries to alter their exchange rates or to impose exchange restrictions.27

The final form of the International Monetary Fund (IMF) was established at a formal conference in Bretton Woods, New Hampshire in July 1944. At Bretton Woods, British and Australian ideas of a Clearing Union which would be an automatic source of credit to member nations which could protect themselves, if necessary, by exchange rate changes and exchange restrictions, were defeated. The American plan was that the IMF should be a conditional provider of financial aid to nations which adhered to multilateral principles in a world of stable exchange rates.28 Under the finalized version of the IMF, member countries were only allowed to alter their exchange rates to correct a 'fundamental disequilibrium' in their balance of payments. In general, member countries were forbidden to use exchange controls. But the British did win a victory with the 'scarce currency' clause.29 This clause allowed member countries to impose exchange restrictions in the event of a currency becoming scarce within the Fund. The Americans made sure, by limiting the resources of both the IMF and the International Bank for Reconstruction and Development (IBRD), that these institutions would not be used for reconstruction purposes. What the Americans had established at Bretton Woods were not institutions to give effect to the Keynesian principle of international expansion, nor reconstruction agencies to deal with the problem of the world dollar shortage. It was a fine tuning system designed to operate in a

27 'Stabilisation Fund and Clearing Union – report of discussions in Washington', by H.C. Coombs, 27 September 1943. Coombs was worried that Australia 'might be subjected to pressure to reduce her standards of living or to follow a deflationary policy because of a refusal by the United States to expand its international purchases to the level of its current income'. CRS A989/1 43/735/56/3, AA.
28 Gardner, op. cit., p.143.
29 Article VII, Section 3.
world where multilateralism and a world balance of payments equilibrium had already been established.

The Australian Labor government had tried to write a commitment to full employment into the Bretton Woods Agreement, but the Americans resisted. The absence of a commitment by the United States to maintain international full employment was the main reason why the Chifley government delayed joining the IMF until 1947. It was worried that a depression overseas would cause a decline in Australia’s export income at a time when domestic policies were keeping prices and wages steady. The resulting balance of payments deficit might force Australia to follow a deflationary policy at home because the IMF would prevent the Australians controlling the deficit through exchange controls. And if the Australians needed to depreciate the pound by more than ten per cent, they would need the concurrence of the Fund that a ‘fundamental disequilibrium’ had occurred. The question of who determined what a ‘fundamental disequilibrium’ was and when it had occurred was a stumbling block for the Australian government. Another problem which John Dedman, the minister for postwar reconstruction, saw was that the IMF could only work effectively after the dollar shortage had been overcome. And a final problem was the inadequacy of the ‘scarce currency’ provisions ‘from the point of view of ensuring that depression in a major country will not generate a vicious spiral’. This was because a general scarcity of the dollar could exist outside the IMF, though the Fund, through restrictions on its lending operations, had ample sources of dollars. Discrimination against the dollar in this case would not be allowed. Moreover even if direct exchange controls against the dollar were permitted, the United States might still

30 ‘Report of discussions at United Nations monetary and financial conference held at Bretton Woods, USA from 1 July to 22 July 1944’, by L.G. Melville, 26 August 1944 CRS A3300/2 item 387, AA.

31 See ‘Notes by the minister for war organisation and industry’, 8 June 1944, CRS A989/1 43/735/51/1, AA.
refuse to change its economic policies, preferring to blame the problem of a dollar shortage on the faulty policies of debtor countries.\textsuperscript{32}

In 1946 Chifley spent a considerable amount of time campaigning for Australian ratification of the international monetary agreement. In that year several doubts about the Fund were cleared up. In October, the executive directors of the IMF confirmed that they would interpret ‘fundamental disequilibrium’ to include countries suffering balance of payments problems because of efforts to maintain full employment. \textsuperscript{33} At the same time Dalton informed the Australian government that the British government would not hesitate to ‘withdraw from the Fund at any time should the Fund attempt to impose any policy inconsistent with its own policy of full employment’.\textsuperscript{34}

The main issue in Australia’s membership of the IMF was the sacrifice of its freedom to alter its exchange rate and impose exchange restrictions. The Chifley government thought that Australia could only make this sacrifice if it was allowed freedom under the new international trade organisation to deal with balance of payments problems by the use of import restrictions. In November 1946 Coombs reported to Dedman that the new trade rules would almost certainly allow the use of import restrictions to defend full employment. He argued that the United Kingdom was basing its hopes of economic revival on international agreements directed towards full employment and the reduction of import duties and other trade barriers. Britain had to be able to export more to the United States in order to survive. Coombs thought that the paramount reason why Australia should join the IMF and the new trade organisation was because Australia’s economy was

\textsuperscript{32} ‘International Monetary Fund – notes by the minister for postwar reconstruction’, January 1946, CP286/3/1 Bundle 6/1533 Part 1, AA.

\textsuperscript{33} Telegram 1368 Australian embassy Washington to department of external affairs, 2 October 1946 CRS A3300/2 item 387, AA.

\textsuperscript{34} \textit{Ibid.}, telegram 1367 Makin to Evatt and Chifley, 2 October 1946.
dependent on Britain’s, and because multilateralism would assist the economic recovery of the United Kingdom. 35

The Labor party was suspicious of the Bretton Woods agreement and it took Chifley until 1947 to convince it to let the Australian government join the IMF. The story of Chifley’s long battle to sell Bretton Woods to the party has been told elsewhere.36 Beresford and Kerr argue that Chifley’s success in persuading his government to join the IMF and the General Agreement on Tariffs and Trade was a turning point in Australian history: an attempt to reorient the Australian economy away from a declining British empire towards the powerful American economy. This was not the case at all. Chifley was aware of the defects of the IMF. But the alternative to remaining aloof from the IMF and the new economic order was isolation. Chifley’s hope was that the benefit from Britain and the dominions moving in the direction of multilateralism would be the economic recovery of the sterling area and the avoidance of depression. In a passionate defence of Australia’s decision to join the IMF, Chifley declared:

I have been an ardent advocate of all international organisations because I believe that through them, we are engaging in a great human experiment, which is designed to prevent the catastrophes that result from wars and financial and economic depressions.37

The International Trade Organisation

The duty to participate in tariff negotiations and in the drafting of a comprehensive code to govern the conduct of world trade was a formal obligation of Australia’s signing the mutual aid agreement. Accordingly, the Labor government sent representatives to the conferences which, under the auspices of the United Nations, set about drafting a charter for an international trade organisation and negotiating

35 Telegram 23 Coombs to Dedman, 18 November 1946, CP 286/3/1 Bundle 6/1533 Part 1, AA.
a reduction of tariffs and preferences. American policy was that the International Trade Organisation (ITO) should bring about the reduction of barriers to trade in order to increase the total volume of world trade. The Australian approach, in contrast, was that the reduction of barriers to trade would count as nothing if the major industrial nations did not maintain a high demand for internationally traded goods.38

The Chifley government’s aim was to write into the ITO charter an international commitment to full employment and also to secure the right of developing and primary producing countries to industrialize behind tariff walls. Australia had already had the satisfaction at San Francisco in 1945 of seeing the full employment objective written into the United Nations charter. At the Bretton Woods conference in 1944 it had not been so lucky. The next opportunity to secure the international recognition of full employment came at the preparatory committee meeting of the trade and employment conference in London in 1946. 39

The Australian government tried to amend the charter to stop creditor countries from persistently causing balance of payments difficulties to other countries. 40 The Australian government feared that the United States would export depression by persistently selling to overseas countries much more than it was either buying from them or investing in them. The Australians tried to place the onus of correcting this imbalance on the United States alone: by imposing a legal obligation on the Americans to import more from other countries, to appreciate the dollar, to inflate America’s cost and price structure, and to invest more abroad. The American reaction was predictable. The American delegation

39 ‘International recognition of full employment policy – an Australian objective’, 26 November 1946, CP486/2/1 item 421, AA.
40 Telegram 14 Australian High Commission London to Dedman, 24 October 1946, CP 486/2/1 item 421, AA.
declared the proposal inadmissible: 'It applied exclusively to the United States. It carried the possible implication that instability in other countries was attributable solely to the United States. And it imposed an obligation on the United States alone'. This amendment failed but the Australians and the British secured a great deal of freedom for member countries to impose import restrictions to defend full employment. The Australians also proposed that the ITO should promote international agreements to stabilize the price of primary products; promote the counter-cyclical use of investment in public works; and promote the flow of capital during times of depression to countries where full employment was endangered by balance of payments difficulties. The Americans strongly resisted a policy which meant that the United States would have to finance the trade deficits of 'full employment' countries by increasing the export of capital from the country in which depression was developing. While not fully embracing the Australian position, the London draft charter of the ITO allowed for the use of import restrictions and for discrimination in their application by countries protecting full employment. While the charter stopped short of giving countries complete freedom in their use, it was nevertheless a departure from the full rigour of multilateral principles.

The London draft charter of the ITO was the basis of further discussions at Geneva between April and August 1947. This meeting was the foundation for the General Agreement on Tariffs and Trade (GATT). The Americans hoped if not for the complete elimination of imperial preference, then for the abolition of all preferences which were obstacles to American trade. But with Britain approaching an economic crisis caused, it seemed, by the harsh economic demands of the United States in 1945, opinion in favour of the retention of imperial preference was

41 Quoted in Gardner, *op. cit.*, p.276.
hardening. The Americans did not aid their cause by passing a price support bill for the United States wool growers. Because of the immense importance of wool to both Australia and the entire sterling area as a dollar earner, the Chifley government threatened to withdraw from the Geneva conference. It was only dissuaded from doing so when the president vetoed the wool bill. 44

The Americans offered tariff reductions of up to fifty per cent but the British promised only to keep preferences at their existing levels and hardly any elimination of preferences at all. The American administration, which had set out to abolish imperial preference, was placed in a dilemma: either to accept the British offer or abandon the Geneva conference. Chifley’s attitude was that if the surrender of imperial preferences would help to persuade the Americans to alter the terms of the non-discrimination clause of the 1945 loan agreement ‘he would be prepared to face the issue, although the question is full of political dynamite’. 45

The British were suffering a severe balance of payments problems with America, which would soon force them drastically to cut imports from the United States. Chifley did not want cuts of a similar size being placed on Australian goods because of the legal obligation under the Anglo-American Loan Agreement binding the British not to discriminate against the United States. Because of Chifley’s anxiety for American aid to Britain in her disastrous financial position, he wanted the negotiations between the dominions and the United States to bear fruit. In its own negotiation, Australia gained from the Americans a twenty five per cent cut in the American duties on wool and a fifty per cent cut in the duties on beef, mutton, lamb, and butter. Australia would not derive any immediate benefits from these cuts since the American demand for Australian wool was not likely to increase

much, and Australia’s food products would not be diverted from their assured markets in Britain. Australia’s concessions on its own tariffs covered a much wider range of the trade of the United States with Australia. But despite America’s advantage in the bargaining, Chifley considered that in the long term, access to American markets was of critical importance for Australia’s exports. The Americans decided not to let the issue of imperial preference wreck the conference and accepted the modest concessions offered by Britain and the dominions in scaling down their preference arrangements.

In a cabinet agendum of early 1948 Chifley recommended that Australia ratify the ITO charter because the signatories had pledged themselves to maintain full employment. Moreover Chifley pointed out that the United States was generally obligated under the charter to pursue liberal trade policies, while other countries were given a wide degree of latitude to resort to devices such as import restrictions to protect themselves from American competition and swings in the business cycle. For this reason Congress refused to ratify the charter. But the president ratified by executive agreement that part of the charter relating to tariffs - the General Agreement on Tariffs and Trade.

When the Labor government’s policy towards the I.T.O. was debated in parliament in February 1948, the leader of the opposition launched a scathing attack on American multilateralism. Menzies explained that multilateral trade treaties worked on the principle that if one nation made a trade concession to another nation, then that concession would extend to all other nations through the operations of the ‘most favoured nation’ clause. In effect therefore, discriminatory

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46 ‘Report on negotiations with the United States of America’, 10 October 1947, CP 596/1/1 Bundle 3, AA.
48 ‘Charter for an international trade organisation’, Agendum 1019 G, 1948, CRS A571/1 44/1109 Part 1, AA.
bargains between nations would be brought to an end. He commented that Australia's economic well being depended on its ability to make discriminatory bargains with the United Kingdom and countries in the British Commonwealth. The burning problem in world trade in 1948 arose from the relationship of the United States with the rest of the world. Consequently:

the first thing that has to be done in regard to world trade is not a multilateral one; it does not concern 50 or 60 nations purporting to exchange obligations with one another. If the United States views the problem facing it the first thing needed is for that country to adapt its tariff policy and national economy so as to buy more from the rest of the world.49

Other opposition members pursued the same themes. P.C. Spender, for example, argued that multilateral trade agreements sought to place all nations on an equal footing at a time when the United States was enjoying huge trade surpluses and the United Kingdom was suffering massive trade deficits. Thus if multilateral trade agreements were to be implemented, they would perpetuate the disadvantageous position in which Great Britain was already placed. Spender argued that Australian policy should not be directed towards multilateralism but rather towards developing the British Commonwealth.50

Chifley replied to the opposition arguments in the course of the debate. He pointed out that since Australia was a party to the mutual aid agreement, it was obliged to take part in conferences leading to the reduction of tariffs and other forms of trade discrimination. He added that the United Kingdom desperately needed a reduction of world trade barriers if its economy was to survive the aftermath of the war. Because the United Kingdom had lost a huge proportion of its overseas investments during the war, it now had to import fully fifty per cent of its imports from dollar sources. Tariff barriers had to be reduced to enable Britain to export more to North America so as to able to pay for all the goods she imported

from the United States. Moreover just as the promise to reduce trade barriers had been instrumental in persuading the United States congress to grant a dollar loan to Britain in 1945, so the trade agreements of 1947 would be vital in persuading the American people to support the Marshall programme of massive dollar aid to western Europe, on which the economic recovery of the whole world depended. 51

The Sterling Balances, the Convertibility Crisis, and the Resurrection of the Dollar Pool

The Loan Agreement of 1945, the International Monetary Fund, and the International Trade Organisation were the three instruments which the Americans were using to create a multilateral system of world trade. The Australian Labor government agreed that multilateralism should be the long term aim of all nations but argued that it could only be achieved if countries agreed to pursue policies of full employment and only if the United States, as the sole creditor nation, agreed to buy more, loan more, and invest more, in the rest of the world. Accordingly the Labor government had tried to make the abolition of imperial preference during the loan negotiations conditional on the Americans agreeing to lower their tariffs and invest more abroad. And it had tried to mould the IMF and the ITO into instruments which would maintain full employment in the world economy. In the case of the IMF, it had failed, and though it was moderately successful with the framing of the charter of the ITO, Congress failed to ratify the new trade rules. Its policy of full employment was in tatters by the end of 1947, but so was America’s multilateralism. They both foundered on the rock of the dollar shortage.

The main aim of the Loan Agreement was to achieve sterling-dollar convertibility. If sterling became convertible, countries inside and outside the

51 Ibid., pp.253–6.
sterling area would be able to use the sterling they earned from trade with Britain, to import dollar goods without any restrictions. Sterling dollar inter-convertibility would lead much of the world into an economic area based on the principles of article VII. However if sterling was to remain a soft currency, Britain’s trading partners would be forced to earn money which could only be spent in Britain or the rest of the sterling area. 52 The problem was that the United Kingdom could only sustain convertibility if the shortage of dollars in the sterling area were alleviated. In other words the United States had to import from the sterling area roughly as much as it sold.

This was not to be. The United States ran an export surplus of $8 billion in 1946. In 1947, this surplus instead of diminishing rose further to $11 billion. Britain’s balance of payments position drastically worsened. It showed a deficit of $2,180 million in 1947, as compared with $1,376 million in 1946. The combined dollar deficit of the United Kingdom and the rest of the sterling area reached $1,900 million in the first half of 1947, and $2,231 million in the second half - $4,131 million for the whole year. To finance this deficit, the United Kingdom’s drawings on the American loan were $500 million in the first quarter of 1947 and $950 million in the second quarter. At that rate the loan, instead of lasting until 1952, would be exhausted at the end of 1947.53 The British explained to Chifley that:

the main upsetting factors have been the big rises in the prices of food and other upheavals, the disappointment of recovery in Europe, and to a lesser extent, the severe winter which curtailed production. Moreover further unexpected factors are now causing an additional drain of United States dollars. These arise from the world shortage of dollars, which reflects the enormously favourable balance of payments of the United States.54

52 Newton, op. cit., p.166.
53 Gardner, op. cit., p.308.
54 Telegram 67, dominion office to UK high commissioner in Australia, 13 August 1947, PRO, JCP, Reel 6009, Print 204, NLA.
Convertibility took effect on 15 July 1947. A week after the introduction of convertibility there was a huge outflow of capital from Britain. Foreign holders of sterling were putting sterling down in settlement of current transactions with the United States and obtaining dollars for their sterling on the New York and London stock markets. Moreover Britain's trading partners accumulated dollars at the expense of Britain, by stepping up exports to the United Kingdom and by using restrictive practices to cut down on imports. The effect of convertibility was to worsen Britain's already disastrous balance of payments problem. 55

The convertibility crisis was a disastrous setback for multilateralism. Its effect on the Australian government was to push it into a pro-sterling area economic policy. Chifley needed access to international reserves to maintain his full employment, development, and immigration programmes. But he did not want to borrow dollars from the IMF or from the United States, except as a last resort. He wanted to protect Australia's sterling balances. Under the loan agreement of 1945, the United Kingdom had undertaken to divide the sterling balances into three categories: some to be written off as a contribution to the war effort; some funded; and some made immediately available for spending anywhere in the world. 56 Although the Americans agreed to let the British negotiate with each creditor individually, they understood that the bulk of the £3000 million of sterling balances would be brought under British control, and that only about £200 million would be released between 1946 and 1950. Moreover they also understood that these releases would be matched by an equivalent contribution by the countries in the overseas sterling area and thus would involve no net drain on the central reserves of the sterling area. 57 Such a settlement could only have been achieved,

56 'Funding' the balances meant converting them into long term loans to Britain which would be paid back eventually, but which could not be used immediately by her creditors.
without American aid, if the British had persuaded its creditors to write off most of their balances. The British were not prepared to wreck their relations with Egypt, India, and other countries by doing this. But they entered into negotiations to impose strict restrictions on their creditors’ access to the sterling balances. And this conflicted with Australia’s determination to preserve a cushion of semi-convertible reserves against the possibility of depression.

In 1944 the Australian government had regarded it as ‘essential [after the war] to enjoy the right of access to a certain minimum of our overseas reserves outside the Fund’. In particular it wanted from the British a ‘firm assurance that a certain minimum of our London funds, such as £40 million, should be free after the war’. 58 Without trying to press for a formal arrangement the Australians wanted an understanding that ‘should the necessity arise our frozen sterling balances would be made available to us, provided the decision as to whether the necessity had arisen rested with us and not the United Kingdom treasury’. 59 This question was worrisome to the Australian government. L.G. Melville, of treasury, even recommended that Australia build up its own hard currency reserve during the war while American soldiers were still spending dollars in Australia. For he quite rightly predicted that the British government would have to restrict the use of sterling to purchase dollars after the war, whether the sterling was derived from current credits or from accumulated balances. 60

In 1946, Dalton explained to Chifley that the £3000 million debt accumulated by the United Kingdom was largely owed to India and Egypt. He thought it ‘essential that an approach to the latter countries should be based on some overall formula of wide application, so that the larger contributions which we should ask

58 External affairs cablegram 51 to the Commonwealth government’s accredited representative in London (Bruce), 31 March 1944, CRS A571/1 44/1660 Part 1, AA.
59 Ibid., cablegram 76 S.M. Bruce to treasurer, 29 April 1944.
60 ‘Sterling balances’, 15 November 1945, CRS A571/1 44/1660 Part 1, AA.
from them have to be derived from some common principle’. Dalton wanted to derive that principle from his treatment of Australia’s balances. Specifically he wanted Chifley to write off half of Australia’s £150 million sterling balances as a contribution to the British war effort. He was trying to use Australia’s comparatively modest balances as a paradigm for scaling down the huge balances of India and Egypt. This was extremely galling to Chifley, who pointed out that India’s and Egypt’s sterling balances had resulted from British war expenditure in those countries. Australia’s balances had not resulted from British war expenditure in Australia but rather from her earnings of hard currencies from American servicemen which he had loyally deposited in the sterling area’s common dollar pool. Chifley replied that the ‘political difficulties in the face of [such a] sweeping gesture were insuperable’ and that the British formula would reduce Australia’s external reserves below the minimum safe level.61

On 15 January 1947 Coombs wrote to Chifley that the British had changed their views since Chifley’s visit in the preceding year. They now suggested that Australia should write off £20 or £30 million from its balances ‘with an unwritten but definite guarantee that, should Australia’s balances fall to a critical level, the amount would be written back’. 62 Accordingly Chifley made a direct grant of £A25 million to the United Kingdom as a gesture towards scaling down Australia’s balances. The grant was disguised as a contribution to the costs of the United Kingdom in the Pacific war. 63

The Chifley government had thus made an effort to scale down Australia’s sterling balances. But the question of the availability to Australia of the remainder

61 ‘Notes of conversation between the chancellor and Mr Chifley’, 1 May 1946, CRS A571/1 44/1660 Part 2, AA.
62 Coombs to Chifley, 15 January 1947, CRS A571/1 44/1660 Part 2, AA.
of its sterling balances remained. Unfortunately for Australia the United Kingdom was now in a position that it could not afford to allow other countries to draw down the sterling balances. For then the British would be exchanging real exports against book debts, instead of imports. The Chifley government was adamant that it needed to be able to draw on at least part of its London funds: first, in case it suffered a balance of payments crisis caused by the spread of recession from abroad; and secondly because the government was embarking on an ambitious immigration and development programme financed from Australia’s own resources and without borrowing from overseas. If it was not going to borrow overseas, the government at least wanted to be able to draw on the past savings of its international reserves.

Coombs advised Chifley not to negotiate a formal freezing arrangement of Australia’s balances. He suggested a general understanding with the British that Australia would be reasonable, would consult with the United Kingdom, and would on average keep imports within its export income. 64

Chifley concurred in this advice and sent S.G. McFarlane, secretary to the treasury, to London to negotiate the matter telling him that Australia did not want to have to borrow from the IMF with sterling balances in London. 65 The British had other ideas. They wanted an assurance from Chifley that Australia would not draw on any of their accumulated sterling balances but would live within its export income for each year from 1947-8 onwards. They wanted Australia to finance its dollar deficits from the IMF and not from the Bank of England, and in addition to intensify import restrictions against American goods. 66 The Australian government was furious with these requests, holding that the British were breaking the spirit of the loan agreement by getting the dominions to discriminate against

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64 ‘Sterling balances – heads of discussion with Mr Dedman’, by F.H. Wheeler, 2 June 1947, CRS A571/1 44/1660 Part 2, AA.
65 Crisp, op. cit., p.281.
66 ‘Sterling balances’ by S.G. McFarlane, 23 June 1947; and letter from G.Rowe Dutton to McFarlane, 3 July 1947, CRS A571/1 44/1660 Part 2, AA.
dollar trade. 67 Chifley immediately cabled McFarlane that the British requests were unacceptable. 68

Chifley gave three reasons why Australia could not live within its income in each twelve month period. The first was that its external trade and balance of payments were not susceptible to such detailed government management. The second was that Australia’s export income was subject to seasonal fluctuations in each year and to temporary ups and downs over a number of years. And the third reason was that the result of trying to live within current earnings would be excessively severe restrictions designed to ensure equivalence of income and outlay on [the] worst possible expectations or [the] necessity continually to seek concessions from [the] United Kingdom in [a] manner which would place detailed control of Australian trade policy in [the] hands of [the] United Kingdom. 69

In July the Australians persuaded the British not to ask Australia to live within its export income for any specific period. Chifley suggested the compromise that Australia would agree not to draw on £150 million of the balances as long as it had the right to draw on a minimum balance of about £25 million. He suggested that Attlee should put his request to the Australian government in these terms:

My hope is, however, that you would keep any temporary drawing down of your balances to the minimum practicable and that you would thereafter restore those balances as rapidly as possible if necessary by measures to check consumer demand.70

This formula did not ask Australia to live within its export income within any specific period and wrote in the principle that Australia should have unconditional access to a minimum working balance of fully convertible sterling. The British

68 Ibid., Chifley to McFarlane, 17 July 1947.
69 Ibid., external affairs cablegram 2805 reflecting comments of treasury and bank, 7 July 1947.
70 Cablegram 3322 Chifley to McFarlane, 6 August 1947; ‘Hasty comments on draft letter from Attlee received from McFarlane on 25 July 1947’, by F.H. Wheeler CRS A571/1 44/1660 Part 2, AA.
relented and framed their request to Australia in these terms, also asking Australia to intensify import restrictions against America, and to sell its yearly gold production to the United Kingdom.71

Chifley’s cabinet considered a response to the United Kingdom’s request on 15 August. The treasurer’s agendum warned that, according to the wording of the 1945 loan agreement, the Americans were expecting the formal convertibility of sterling to have the result that ‘any discrimination arising from the so called sterling area dollar pool will be entirely removed’. And since the United Kingdom was bound, under the agreement, to make Australia’s earnings of sterling after July 1947 available for spending in the dollar area, Chifley thought that the Americans might argue that there was no longer any ground for further discrimination against American goods by Australia. He recommended, however, that cabinet should agree to continued import restrictions on dollar goods because the British had given Australia some latitude in drawing down its accumulated sterling balances.72

A few days later, this delicate compromise between Australia and Britain was shattered. Reeling from the effects of convertibility, the United Kingdom revealed to Chifley, on 18 August, the full extent of its disastrous position. Foreign holders of sterling were speeding up the payment of sterling to dollar countries. And they were running down their capital in sterling at the cost of the United Kingdom’s reserves. The British pointed out that the dollars loaned by Britain to the Americans and ‘intended for the establishment of United Kingdom equilibrium...have been flowing away to finance the dollar deficits of practically the whole of the rest of the world’. 73 This included countries in the rest of the

71 Telegram 67 Attlee to UK high commissioner in Australia, 13 August 1947, PRO, JCP, Reel 6009 Print 204 NLA.
72 ‘Conservation of dollars’, cabinet agendum 1376, 14 August 1947, CRS A1068/1 ER47/8/8, AA.
73 Telegram 68, UK government to UK high commissioner in Australia, 18 August 1947, PRO, JCP, Reel 6009, Print 204, NLA.
sterling area who were financing their dollar deficits by drawing on the accumulated sterling balances which Britain had so far failed to neutralise. The United Kingdom announced that it was suspending the right of non-sterling countries to spend their sterling freely in America and Canada. As for sterling area countries, the British stated that they were prepared to meet their dollar demands as presented but they would ask for even more discrimination against American goods and for ‘immediate discussions as to the scale of dollar expenditure which can in future be contemplated’. In effect the British were asking for the resurrection of the sterling area dollar pooling arrangements. Britain beckoned Australia and her sister dominions to join in a full scale retreat from multilateralism.

On 2 September the Australian cabinet met again to discuss the convertibility crisis. Chifley told cabinet that the Americans had reluctantly agreed to the United Kingdom’s suspension of convertibility and were engaging in high level discussions on the non-discrimination obligation imposed under the loan agreement. This section required that if the British imposed import restrictions on American goods to protect their balance of payments, they had to impose similar restrictions on the goods of all other countries, including the dominions. This worried Chifley because not only did he have to restrict essential American imports from coming to Australia, but he also had to face the prospect of the British restricting Australian imports because of their legal obligations to the Americans under the loan agreement. Chifley recommended that Australia rejoin the sterling area dollar pool and also impose severe restrictions on American trade. These restrictions covered a range of goods including tobacco, textiles, petrol and oil, aircraft, motor vehicle chassis and parts, machinery, and electronic equipment;

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75 Telegram 68.
and the cuts amounted to about £17 million out of a total level of trade with America of £64 million in 1946. Imports from America were cut by a third at one stroke.76

J.G. Crawford has remarked that there was no serious examination by the Labor government of Australia withdrawing from the sterling area in these circumstances.77 This was a matter of economics as well as sentiment. Chifley told cabinet that if Australia withdrew from the sterling area, the government would have to restrict imports of dollar goods to Australia's dollar income.78 Treasury had advised Chifley that the United Kingdom remained the predominant market for Australia's primary produce, and that Australia's dependence on primary products was not likely to be changed remarkably by the development of secondary industry. Australia's deficit with the dollar area in 1946 was £A32 million. Treasury advised that if Australia left the dollar pool, if all Australia's gold production were sold to the United States, and with the import restrictions already made, there would still be a deficit with the dollar area of £11 million (about $40 million) in 1947-8. A break with the sterling area would mean that Australia would have to restrict imports from the dollar area even more harshly than if she remained with the sterling area.79 The advantage of the dollar pool was that Australia could withdraw more dollars than she put in. And in fact Australia had to look to the dollar pool in 1947-8 for $164 million to balance her dollar account.80

Unfortunately for Chifley, the United Kingdom government's policy towards Australia hardened after the suspension of convertibility. Before the

78 'Conservation of dollars', cabinet agendum 1376.
79 'The external financial position of the United Kingdom – Australian policy', September 1947, CRS A1068/1 ER 47/8/8, AA.
80 Crisp, op. cit., p.309.
suspension of convertibility the British had tried to prevent Australia from making any drawings on her accumulated sterling balances. Now the British wanted to prevent Australia from drawing surplus dollars from the reconstituted dollar pool. On 3 September they informed Chifley that they 'should frankly be greatly disappointed if it turns out that Australia cannot find means of living within her dollar resources...' And later, Lord Addison, the secretary of state for Commonwealth relations, made a firm request that Australia live within its dollar income. The consequences of Australia being forced to live within her dollar income, while remaining a member of the sterling area, would be worse than if she left the pool altogether. Chifley stated that Australian trade policy would be forced to undergo a revolutionary change:

we should be forced to redirect exports to earn the maximum amount of dollars and to take steps to ensure that [the] dollar proceeds are received directly by Australia. Both these changes would have serious effects on [the] United Kingdom in that [the] former would affect the volume of our exports to [the] United Kingdom and [the] latter would affect the volume of world trade financed through London.  

In the end, the United Kingdom government agreed that Australia could have free access to part of her accumulated balances and to the dollar pool as long as these funds were withdrawn with caution. The Chifley government, for its part, had agreed to sell its current gold production to the United Kingdom and to economise on dollar expenditure roughly in accordance with British policy. The Australian government retreated from multilateralism in the face of the threat of the dollar shortage and an American depression and staked Australia's economic salvation on the sterling area and British recovery. Chifley was accused by the maverick independent, J.T. Lang, of following a policy which could only end in an

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81 Telegram 94 Commonwealth relations office to UK high commissioner in Australia, 3 September 1947, PRO, JCP, Reel 6009, Print 204, NLA.
82 Telegram 96, text of Chifley’s letter to Lord Addison, 4 September 1947, PRO, JCP, Reel 6009, Print 204, NLA.
83 Telegram 98 Attlee to UK high commissioner in Australia, 11 September 1947, PRO, JCP, Reel 6009, Print 204, NLA.
artificial dollar depression: 'it will wreck our trade with the United States of America and deprive many of our industries of critical supplies, leading to complete dislocation and a progressive breakdown in the Australian economy'. ⁸⁴

And the Country party's J.P. Abbott argued:

the action taken by the government to meet the dollar crisis is entirely unlikely to bring about the golden age which the prime minister spoke about so glibly last year; rather will it bring about a depression. If a depression overtakes us, the guilty men will sit on the other side of the house.⁸⁵

Chifley replied emotionally:

We desire to extend to the United Kingdom all possible assistance, while striking a fair balance in order to ensure that our own people do not make undue sacrifices. This course is to be preferred to seizing every opportunity to sell our exports in the hard currency and the dollar area. The United Kingdom, which urgently needs these goods, has been, and will be, our greatest customer for decades. Are we to ignore the plight of the United Kingdom because some temporary customer requires these goods and is prepared to pay dollars to pay for them? Are we to deprive our greatest customer, friend, and ally, of these goods?⁸⁶

The opposition, in the course of the next two years, were to answer these rhetorical questions in the affirmative and to win the 1949 election partly on the basis of opposition to Chifley's pro-sterling area economic policy.

**The Attempted Nationalisation of the Private Trading Banks**

The Chifley government decided to nationalise the private trading banks in August 1947. The reasons for this decision have been the subject of much debate. Some historians follow contemporary political critics like C.V. Janes, and attribute the bank nationalisation decision to Labor's desire to implement its socialist platform. ⁸⁷ David Stephens, however, has claimed that bank nationalisation was completely

devoid of socialist intent. For Stephens, it was a pragmatic measure taken for pragmatic reasons within a private enterprise economy for the purpose of making capitalism more efficient.  

88 I agree with Stephens that the decision was undertaken less for ideological reasons than from the need to guarantee Australia’s security against depression in circumstances where international collaboration had failed and the United Kingdom was on the brink of economic collapse.

The decision to nationalise the banks is puzzling in the light of the Labor government’s cautious attitude to its 1945 legislation. This legislation established a central banking division within the Commonwealth bank with power to regulate the Australian banking system and responsibility to a single governor, who in turn was directly responsible to the Commonwealth government.  

89 In submitting the legislation to cabinet in January 1945, Chifley said that he would exclude all of the wartime banking provisions that were not ‘essential for effective control and which would lend themselves to propaganda and would injure our credit overseas’. The three main provisions of the legislation were the provision that the trading banks lodge a certain proportion of their assets with the Commonwealth bank so as to prevent inflation; the provision that the Commonwealth bank could regulate the direction of bank advances; and the provision that the Commonwealth bank would control foreign exchange transactions.

90 A contentious provision of the 1945 legislation was section 48, which prohibited trading banks from carrying out banking business for a state, or any authority of a state, including local government authorities. Chifley stated, in his

90 Attachments A – D Agendum No. 768 ‘Proposed bill to regulate the Australian trading banks’, 5 January 1945, CRS A432/1 49/82 AA.
second reading speech on the bank nationalisation bill, that section 48 embodied the principle that
government banking business should be conducted through the central bank so as to give the central bank added strength to control the supply of credit and to enable it to take action in time to offset any disturbances to credit conditions resulting from government operations. 91

This was the section of the act which the Melbourne city council successfully challenged in 1947 and which triggered the decision to nationalise the private trading banks. But in 1945, Chifley was not anxious to include the provision. He thought that if all public authorities were constrained to bank with the Commonwealth bank, its limited resources would be strained beyond capacity.92 However cabinet overruled Chifley and the solicitor-general advised him that the provision was almost certainly constitutional.93

The high court found section 48 of the banking act to be invalid in 1947 because of the doctrine of implied immunities: a federal law could not discriminate between the states or violate an essential function of a state. The high court decided that a state instrumentality, such as the Melbourne city council, had the right to manage its own funds, including a right of access to adequate banking facilities. But as Galligan has argued, the assumption of the judges that this entailed a free choice among pre-existing private banks, was one completely lacking in constitutional foundation. 94 Evatt agreed, writing to Chifley on 14 September complaining of the ‘interpretation of law by judges, who have recently delivered a judgement, which in the opinion of Bailey and all the constitutional lawyers,

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93 Opinion of the solicitor-general on the constitutionality of section 48 of the banking act, 11 January 1945, CRS A432/1 49/52, AA.
94 Galligan, op. cit., p.197.
including myself, is so bad as to be indefensible'. 95 Chifley publicly stated that 'the decision showed that full control of banking as sought under the 1945 legislation could not be secured without public ownership of banking'. 96 This statement is puzzling in the light of Chifley's opinion in 1945 that section 48 was not essential for the public control of banking.

Chifley could not have considered the loss of section 48 in itself so important as to justify the nationalisation of the banks. Challenges to other areas of the legislation in the future was the worry. The Melbourne city council had challenged sections 18 to 22 of the banking act in its statement of claims, though it eventually decided not to press that line of attack. These sections related to the special accounts lodged by the trading banks with the Commonwealth bank. The argument was to be that sections 18 to 22 were taxation measures, and that under the constitution, any law imposing taxation could deal with no other matter. Chifley argued that an attack on these sections could not be tolerated: 'It would be disastrous, from the point of view of the people of Australia, if sections 18 to 22 of the banking act were held to be invalid, and the consequent loss of the banking system led to an inflation of credit, with all the loss and distress that inflation entails'. 97 Here was Chifley's fear. If the Commonwealth lost control of the banking system, even temporarily while the court decided the issue, the banks would unleash an inflation through the uncontrolled issue of credit. This inflation would be a disaster on the eve of a major depression and it would put so much pressure on Australia's London funds that Chifley would not be able to fulfill the gentleman's agreement he had made with the British to try to get Australia to live within her means. Moreover Chifley had every reason to believe that when the depression did come, the banks would not cooperate with the government. He would be under pressure from the British not

95 Cablegram El Evatt to Chifley, 14 September 1947, CRS A432/1 49/52, AA.
97 Chifley, op. cit, p.110.
to draw on Britain's reserves, and unable and unwilling to borrow from the United States. With the system of international collaboration in tatters, Chifley wanted absolute control over the banking system to issue the credit necessary to counter the effects of depression abroad. Chifley argued:

The difficulties of the transition from war to peace are far from over. In fact, in some directions they are increasing. The dollar crisis is not yet solved and general economic conditions overseas are very unstable. It would be unwise not to prepare for serious repercussions on the Australian economy in the near future.98

Chifley took the decision to nationalise the banks partly because of the threat from the private banks to the 1945 banking legislation, but more so because the economic situation in 1947 was of such apparent instability as to demand drastic measures from a government dedicated to full employment.99 Bank nationalisation and a pro-sterling area economic policy were reactions to the international economic crisis, and to the failure of the Americans to underwrite the system of international economic collaboration with massive dollar aid and with policies designed to promote full employment internationally.

CHAPTER TWO - THE CHIFLEY GOVERNMENT AND THE DOLLAR SHORTAGE

By the end of 1947 the American policy of multilateralism had suffered severe setbacks. The United Kingdom's once powerful economy was on the verge of collapse; the sterling area countries had been reconstituted as a discriminatory bloc against dollar competition and had been forced to impose severe restrictions on American imports; and western Europe was in ruins. Congress was refusing to ratify the ITO charter and there were rumblings in the British government of the need to create a Commonwealth customs union. The most serious problem of all was that the dollar gap between the United States and the rest of the world was increasing. The Chifley government had to develop a policy to maintain Australia's economic security in the face of the growing dollar shortage and the threat of depression. The Labor government's plan was to try to become independent of dollar supplies, to promote intra-sterling area trade, and to develop Australia's economy with British and Australian capital. This was a policy of stability – insulating Australia from the dynamic yet unpredictable American economy. And it was one which the Liberal and Country parties were to reject in favour of a policy of more rapid development and a new economic relationship with the United States economy.

The Inception of the Marshall Plan

The Australian policy of relying on the sterling area presupposed that the sterling area would continue to exist. But the sterling area could only continue with American aid. It is first necessary, therefore, briefly to explain the origins of the Marshall programme of dollar aid to western Europe and the differing ideas of the Americans and the British about the the sterling area and the future position of the United Kingdom in the world economy. On 28 July 1947 the United Kingdom government communicated to the American government an aide-memoire about the dollar shortage. The British argued that they had assumed the multilateral obligations of the American loan in the faith that the United States would take measures on a large scale to assist Europe and to
relieve the world dollar shortage generally. They had understood that the Americans would use the IMF, IBRD, or direct government action to relieve the dollar shortage in the rest of the world. This had not happened. In fact the dollar problem was getting so bad by mid-1947 that Britain would have to cut imports from North America drastically, reduce the supply of dollars to the Middle East, India, and other countries in the sterling area, and cease dollar aid to Germany altogether. The United Kingdom would no longer be able to act as the 'differential gear' between the United States economy and much of the rest of the world. And unless further American assistance was forthcoming, the United Kingdom government would be forced to retreat further and further from the concept of a multilateral world economy.¹

Policy makers in the United States became seriously concerned at the British and European economic crisis. In May 1947 the policy planning staff of the state department advised that economic aid to Europe was America's foremost problem. They believed that the European crisis resulted from the disruptive effect of the second world war on the economic, political, and social structure of Europe, and from a 'profound exhaustion of physical plant and spiritual vigour.'² The Americans did not fear a Soviet invasion of Europe. Rather they feared that indigenous communist parties would gradually gain control of European countries. In so far as there was a strategic dimension to the Marshall Plan it was to prevent any potential adversary or coalition of adversaries from mobilizing the resources and economic–military potential of Europe for war–making purposes against the United States.³ But mainly the Americans feared a European economic collapse which would close off a huge market for America's surplus exports and begin a worldwide depression. They were concerned that, because of the dollar shortage, the European countries would increasingly attempt to eliminate

² Policy with regard to American aid to western Europe – views of the policy planning staff, 23 May 1947, FRUS, Volume III, 1947, p.228.
the dollar from intra-European trade by means of bilateral trade deals, state trading, and exchange controls. The Americans had not given up on multilateralism but they no longer believed that it could be achieved through the existing mechanisms – the IMF, the ITO and GATT, and the Anglo-American Loan Agreement. The Americans now proposed a huge transfusion of dollars into Europe for a limited period, during which time they hoped that European production would increase sufficiently to render unnecessary Europe’s abnormal dependence on American imports, especially of food and fuel. At the same time the Americans hoped that the nations of western Europe would create conditions of free trade with one another and that they would develop some form of economic and political integration. This would be the first stepping stone for the establishment of multilateralism over the whole of the non-communist world. These ideas eventually crystallized into the programme of massive dollar aid to western Europe known as the Marshall Plan or European Recovery Programme (ERP).

The Americans saw the world economic crisis as the result of Europe’s failure to produce. The under secretary of state for economic affairs, Will Clayton, argued that the ‘whole trouble arose from a shortage of dollars but this in turn represented a failure of Europe to produce. The production bottleneck should be eased in a few years – perhaps by 1951.’ Clayton informed the British that the United States had a plan which would ‘restore European production within a stated period to a level which will render unnecessary Europe’s abnormal dependence on imports’ from North America. He suggested the liberalization of trade and exchange controls in Europe and even the formation of a western European customs union. But Clayton ruled out of court British requests for a special assistance programme for the United Kingdom by itself,

saying that he was ‘unable to visualize the administration going to congress regarding new proposals for any country and he felt that a European plan must be worked out’. 6

The British had two objections to the American approach to the world economic crisis. The first was that simply restoring production in western Europe was only a partial solution. This was because even before the war Europe was running with the United States deficits which it was paying for by earning offsetting surpluses with underdeveloped countries in the Far East such as Burma, Indonesia, and Malaya. This pattern of trade had been destroyed by the Japanese in the second world war. Furthermore the cold war had produced a division between eastern and western Europe and a disruption of trade. Consequently western Europe was forced to look to the United States for supplies which it had previously got from eastern Europe. The British argued:

We have difficulty in getting acceptable payment for our exports to Europe and Asiatic countries. Our economy is the bridge between the western and eastern hemisphere. Traditionally we have deficits with the West which are financed by surpluses with the East. The effect of the world supply crisis is that our deficit with the West is inflated to quite unmanageable proportions, while we are unable to get full benefit, in goods or in gold, for our surplus with the East.7

Part of the solution to the dollar problem, then, was to restore the triangular pattern of trade between Britain, the United States, and countries in eastern Europe and the Far East.

The second British criticism of the American approach to the dollar crisis was that that crisis was not the result of western Europe’s failure to produce, in particular, but of a world supply crisis in general. It was the failure of primary production in the rest of the world which was making Europe so dependent on North America. The British argued for some ‘special arrangement’ for the United Kingdom, whereby dollars could be recycled through London to the sterling Commonwealth countries.

many of which, like Australia and New Zealand, were primary producing countries. By increasing the world supply of dollars, an Anglo-American partnership would stimulate the recovery of the eastern hemisphere. The Americans, however, would not recognise the British case for exceptionalism. Assistant secretary Clayton could not see the difference between the United Kingdom and the other western European countries:

He thought that if the UK received dollars from its trade with Europe, their position would be satisfactory. Mr Clayton thought that the Marshall idea would put dollars into Europe by taking care of their essential imports, leaving more of the proceeds of their exports available for payment of goods imported from Britain.\(^9\)

Despite their reservations about the Marshall Plan, the British could not but welcome the dollar aid. The alternative was dismal. In July 1947 the British had considered forming a sterling autarky including the colonies, Australia, New Zealand and possibly Denmark. But without essential imports from the United States, the pursuit of autarky in this form could not have prevented unemployment from rising as high as four million in the United Kingdom. The British did not wish to integrate with Europe completely, as the Americans wanted, but nor did they like the prospect of forsaking American aid and eking out a painful existence through the policies of bilateralism and autarky. The British government compromised by agreeing to make some progress to European economic integration but at the same time to preserve their role as banker to the sterling area.

**The Australian Reaction to the Marshall Plan**

The Chifley government gained its first knowledge of the British response to the Marshall Plan through the communications from the British government regarding Western Union in early 1948. On 14 January 1948 Attlee informed Chifley that the British were responding to the Marshall offer by initiating 'Western Union' – a

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\(^8\) Newton, *op. cit.*, p.396.


movement towards the economic and defensive integration of western Europe. Yet Attlee did not convey to Chifley his government’s determination to mould the European Recovery Programme in accordance with the United Kingdom’s interests – to resist the American policy of integrating Britain completely into western Europe and to maintain Great Britain’s relationship with the sterling area. He was simply concerned to gain dominion support for the basic policy of Western Union. This policy was anathema to the Australian minister for external affairs, H.V. Evatt, whose aim it was to prevent the schism in Europe which the Marshall Plan was designed to consolidate, and to uphold the authority of the United Nations against competing power blocs. The prospect of the economic union of western Europe to the exclusion of the Commonwealth was equally worrying to Chifley. Chifley wrote to Attlee on 11 February complaining that ‘one instance where we are completely uninformed is the matter of a customs union’. And a British foreign office minute commented that ‘out of the welter of criticism of our whole policy, and the reasons behind it, emerges the Australian fear that we might get entangled in a customs union to the exclusion of the Commonwealth.’

Chifley used the Australian high commissioner in London, J.S. Beasley, and the treasury’s representative in London, J.F. Nimmo, to gain as much information as he could about the effect of the Marshall Plan on Australia’s economic interests. Nimmo questioned the new chancellor of the exchequer, Sir Stafford Cripps, on a number of points. He asked whether Australia would retain the right to draw dollars from the sterling area’s central pool during the European Recovery Programme. Cripps replied that as long as there was a sterling area dollar reserve, Australia would be entitled to draw ‘reasonable’ requirements. But there might come a time, if the reserve fell, when Australia’s dollar drawings would become a matter for bargaining between the United

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11 Message from Attlee to Chifley, 14 January 1948, CRS A1838 TS 78/7, Australian Archives (AA).
12 UK high commissioner in Australia to Commonwealth relations office, 11 February 1948, Public Record Office London (PRO) PREM 8/787. I am indebted to C.D. Waters for this reference.
13 Undated foreign office minute PRO FO 371/70189 W919/101/68G. I am indebted to C.D. Waters for this reference.
Kingdom and Australia. Nimmo put to Cripps the Australian government’s fear that British exports would be diverted from Australia to the United States in order to earn hard currency and to western Europe as part of the process leading to European integration. Nimmo thought that Cripps was evasive about this and that the British might sacrifice Australia–United Kingdom trade in order to increase trade with Europe. He recommended that Chifley obtain a written assurance from the British government ‘that we will retain the right to draw reasonable amounts of United States and Canadian dollars from the central reserve and that our trade interests will not be sacrificed for the sake of rehabilitating western Europe.’ 14

On 11 March the British informed Chifley that if congress did not approve the Marshall Plan the United Kingdom would be in a drastic situation. The sterling area would begin 1949 with the certainty that it would have no reserves of gold and dollars by the end of the year. The British government would have to cut food consumption and its supplies of raw material imports with the result that there would be a substantial drop in production and consequently in employment.

We should, in fact, have to conduct an operation as grave and difficult as that needed on the outbreak of war. It will be necessary to take decisive action without delay through the whole economic field and to recast entirely our policy in defence and foreign affairs. 15

And as Cripps told the dominion high commissioners on 27 February, even if Congress approved Marshall appropriations to the United Kingdom of £300 million per annum, it was doubtful whether the sterling area would achieve balance with the western hemisphere during the whole period of the European Recovery Programme. There would thus be no opportunity to relax discriminatory import restrictions in the sterling area and no opportunity to build up the sterling area’s reserves. Indeed when Marshall aid ceased, the major problem of imbalance between America and the rest of the world would not be solved. Cripps therefore stressed the importance of developing new

14 ‘Future Australian trade and international finance policy’, 31 March 1948, CRS A2910/1 453/7/1 Part 4, AA.
15 ‘Memorandum on the 1948 dollar position’, 11 March 1948, CRS A1838 T58 67/1/2, AA.
sources of supplies of raw materials within the sterling area. Moreover he wanted Australia and the other dominions to switch their purchases from the United States to the United Kingdom as soon as the United Kingdom was in a position to supply goods formerly bought from America. Cripps left Australia in no doubt that the receipt of Marshall aid by the United Kingdom would not provide grounds for easing dollar restrictions in the dominions – rather the reverse. Australia could only look to the United Kingdom for more imports.

Congress approved the European Recovery Programme and Cripps met with the dominion high commissioners again on 27 April. He told them that the passage of the ERP act prevented a catastrophe in the United Kingdom’s dollar position but did not permit amelioration. For the participating countries generally the ERP appropriation would do no more than permit a continuation of supplies from the United States at the same level as 1947. In 1947 European countries were drawing on their reserves to finance purchases from the United States; in general now they had no reserves upon which to draw and therefore required large amounts of aid even to maintain the flow of goods and services. Cripps announced that the British government was to use the ERP period to establish its economy on a sound basis by the end of the period. This involved two major lines of action: first to maintain Britain’s reserves throughout the ERP period at about £500 million; and secondly to adopt long term plans to eliminate the dollar deficit by development of non-dollar sources of supply and by building up markets in the dollar countries. Cripps stated that the keynote of western European cooperation was to expand the production of essentials in Europe and so reduce dependence on American aid. He added:

The effect of the cooperation upon which we are embarking will be to strengthen the ties between ourselves and the western European countries but we see no reason why this should weaken our ties with the dominions. Given the purpose of the cooperation, we see no reason for a clash with dominion interests arising out of the policies which will be followed. Europe’s production of essentials is wholly inadequate to meet its needs and

16 Mighell to Chifley, 27 February 1948, CRS A2910/1 453/7/1 Part 3, AA.
17 Ibid., Nimmo to treasury, 1 March 1948.
we should not expect dominion exports of essentials to be prejudiced in any way by the development of production in Europe.\textsuperscript{18}

He warned that the United Kingdom would be under pressure to send capital goods to Europe to assist in the development of European production but said that he would insist upon the need to send supplies to the dominions in order to pay for imports from those countries and to develop long term sources of supply. Cripps finished by affirming that Great Britain had no intention of abandoning the sterling area; on the contrary, the British would try to convince the Americans that the existence of the sterling area widened the field in which reasonably free trading could take place and financed the dollar deficits of individual sterling area countries by methods which would have to be replaced if the sterling area were abolished.\textsuperscript{19}

The Chifley government wanted to preserve the arrangement whereby the United Kingdom financed Australia’s dollar deficits. The sterling area dollar pool gave Australia freedom to convert at least some of its sterling into dollars and thereby gave Australian trade policy a certain flexibility and multilateralism which it would not otherwise have. It also shielded Australia from the strong trend in British economic policy after the suspension of convertibility towards bilateralism. British trade policy was now directed towards curbing imports from North America and redirecting trade to the sterling bloc and other soft currency markets. The British more and more made bilateral deals with other countries, and used quotas, exchange controls, and other devices, to restrict dollar imports and safeguard their reserves. The Australian treasury warned that should the United Kingdom impose a quota on Australia for dollars, or force it to live within its dollar income, Australia would increasingly be forced into bilateralism with America, and more importantly, with the United Kingdom itself. Chifley wanted to continue the long standing arrangement under which the United Kingdom supplied extra dollars to Australia. And not only that,

\textsuperscript{18} Summary of statement by chancellor of the exchequer at meeting on 27 April 1948, CRS A2910 453/7/1 Part 5 AA.
\textsuperscript{19} Ibid., Beasley to Chifley, 27 April 1948, CRS A2910 453/7/1 Part 5, AA.
Chifley wanted the right to draw on Australia’s frozen sterling balances in the event of a depression which, as he told his officials, was a possibility ‘in a world as uncertain and bleak in outlook as the present one’.  

The problem for Australia was that the Americans, while eager to help Britain, were reluctant to bolster the sterling area with Marshall dollars. The United States agreed to provide Marshall aid to cover the dollar needs of the United Kingdom itself, but at first refused to provide for the dollar needs of the countries in the rest of the sterling area. This created the problem that if Australia were to draw from the sterling area dollar pool, it would be taking from the United Kingdom’s basic and irreducible reserve. And the Chifley government had only recently won the battle with the United Kingdom to be allowed to continue to draw from the pool. Indeed Australia and New Zealand were the only sterling area countries which, at least in theory, were able to convert unlimited amounts of sterling into dollars. India, Pakistan, and Ceylon were allotted dollar ceilings, and the dollar demands of the colonies and southern Rhodesia were vetted closely. But if Australia and New Zealand were refused the right to draw on the resources of the pool, the dollar scarcity in those countries would be particularly acute, since the bulk of their exports of primary products were going to the United Kingdom and could not easily be diverted to North America to earn dollars.

The Australian treasury pointed out that if the deficits of both the United Kingdom and the countries in the rest of the sterling area were met by Marshall aid, that is by ERP financing of North American imports to the United Kingdom, Australia would be able to retain its customary flexible arrangement of financing its dollar trade through London with the minimum of interference by outside authorities. The only disadvantage would be that the availability of dollars in Australia would in effect be determined as a result of negotiations in which Australia had no part. An alternative to

20 F.H. Wheeler to E.B. Richardson, 19 April 1948, CRS A2910 453/7/1 Part 6, AA.
21 Ibid.
this scheme was for Australia to participate in ‘off-shore purchases’. This meant that the United States would give participating European countries dollars with which to buy Australian goods.22

However there was no certainty that the Americans would make any efforts to finance the dollar deficits of the countries in the rest of the sterling area. So on 7 May H.C. Coombs, the departmental head of postwar reconstruction, produced a draft memorandum for the prime minister entitled ‘Policy in relation to the dollar problem’. The paper aimed to make recommendations on how Australia could be placed in a position where it did not have to make any net drawings from the sterling area dollar pool by the end of the period of Marshall aid. To achieve that it was necessary for Australia to export more to the dollar area and simultaneously reduce its dependence on dollar supplies. Coombs saw three possible lines of action: the continuation of dollar import restrictions, the replacement of American imports by Australian production, or the diversion to other sources of supply in soft currency countries.23

Of the three possible courses of action Coombs rejected the first. Import restrictions against the dollar area were already severe, and in some cases by preventing the importation of capital equipment, they slowed up the process of replacing goods previously imported from the dollar area. On the second alternative Coombs pointed out that the replacement of American imports by Australian production was not likely to be easy, since aggregate Australian production was already at a maximum and was hampered by widespread shortages of manpower, materials, and equipment. But Coombs saw some possibility of replacing American imports by the Australian production of tobacco, chemicals, motor chassis and tractors, tinplate, newsprint, paper and pulp, and cloth and yarn. Diversion to soft currency sources of supply was similarly difficult. But again Coombs saw the possibility of buying chemicals, machinery, motor chassis, and tractors, from the

22 Telegram 492 Watt to McFarlane, 19 May 1948, CRS A3300/2 866, AA.
23 ‘Policy in relation to the dollar problem’, 7 May 1948, CRS A571/1 48/1555 AA.
United Kingdom. And in the long term there was the possibility of obtaining some of Australia's import requirements from European countries, and obtaining timber, newsprint, paper and pulp from New Zealand and Russia. Coombs' suggestions amounted to a policy of influencing the course of Australia's development in order to promote the production of goods capable of reducing Australia's dependence on dollar supplies and changing its trade policy so as to switch purchases from dollar markets to markets in the sterling area. 24

Two possible methods of reducing the dollar shortage were rejected by Chifley - dollar borrowing and vastly increased American capital investment. F.H. Wheeler explained that the Labor party had always been against American capital taking big profits out of Australia. Chifley, when he was minister for postwar reconstruction, in consultation with cabinet, had decided the general order of preference for Australian economic development as first from Australian capital, second from a combination of Australian and British capital, third from British capital, and only as a last resort from American capital. 25 As Chifley told the house of representatives in September 1948, all schemes of American foreign investment involved the provision of dollars, first for the purchase of plant, and second for the payment of royalties, and third for the payment of dividends back to the United States. He argued that the Australian government was simply not in a position to guarantee the availability of dollars to companies needing dollar goods even a few years hence.26 The inter-departmental committee on dollar receipts summed up the Labor government’s attitude to American investment in November 1949:

It is clear that there is no definite policy towards the investment of private American capital. There have been certain encouragements given to investment when, for example, the investment would lead to the establishment of a valuable industry in Australia, but on the other hand conditions regarding such matters as the division of ownership between Australian and American interests, the methods of raising capital and the

24 Ibid.
25 'Note for file' by F.H. Wheeler, 24 December 1948, CRS A571 45/2024A Part 1, AA.
extent of dividends and royalties, have been imposed from time to time. On the whole the attitude has not been conducive to a high level of U.S. investment.\textsuperscript{27}

In fact American foreign investment as a proportion of total private investment declined from 2.6 per cent in 1947–8 to 1.6 per cent in 1949–50. United Kingdom foreign investment, by contrast, got up to about 10 per cent of total private investment in the last years of the 1940s. \textsuperscript{28}

Throughout 1948 the government continued to wrestle with the problem of how to finance Australia’s dollar deficit. On 20 May the Commonwealth bank advisory council urged the government to seek offshore purchases for Australia through direct representations to the United States government. The council urged that the United States might respond to the argument that Australian trade was generally multilateral in character and that Australia’s dollar deficiency arose because its exports were directed to western European countries unable to pay in convertible currencies. The Australians would argue that one purpose of the ERP programme was to put these western European countries in a position to pay in convertible currencies. By giving them dollars to make off-shore purchases in Australia the United States would be preserving the multilateral character of Australia’s trade instead of destroying it. \textsuperscript{29}

S.G. McFarlane, Chifley’s economic representative in Washington, advised him on 27 May that there was little chance of persuading the Americans to make Australia, like Canada, a general source of off-shore procurement. Australia would not succeed in putting it to the Americans that Australia was a parallel case to Canada, for the simple reason that Canada was a dollar country and Australia a sterling one. McFarlane thought that the American response to a direct request from Australia would be disappointing and might embarrass the United Kingdom. And even if the response was


\textsuperscript{28} Robertson, \textit{op. cit.}, p.160.

\textsuperscript{29} Cablegram 503 Watt to McFarlane, 21 May 1948 CRS A3300/2 866, AA.
favourable, the amount of dollar aid would be very small and would not permit Australia to increase its dollar imports. McFarlane told Chifley that Australia’s economic security depended on the United Kingdom winning out in its long term policy of making the eastern hemisphere less dependent on the western hemisphere and so re-establishing the use of sterling as an international currency.30

So serious was the economic problem confronting Australia and the United Kingdom that Chifley made a special visit to London in July 1948 to talk to Cripps and Bevin. Chifley later justified his trip to the house of representatives:

I did not go to England on a jaunt…I went to London for a very simple reason: I knew that the short term economic problems that faced the United Kingdom and western Europe and were affecting the economies of Australia and New Zealand, would have to be settled before it was possible to call a conference of prime ministers.

He described the objectives of his visit as, first ‘to see that Australia directly or indirectly would receive dollar exchange necessary for our industry and development’; secondly to ‘ensure that Australia received an appropriate proportion’ of British industrial output in short supply, which was essential to Australian industrial progress; and thirdly to discuss the economic way ahead for Britain and Australia in a world where Britain, in particular, despite Marshall aid, was in a specially difficult position, a position liable to grow worse if the recession then threatening in America really developed.31

Cripps reiterated to Chifley that British policy was not to let its reserves fall below £500 million. This meant that the British would have to tailor their imports from North America to the amount of Marshall aid they received. And since the British were regarding their central reserves as also the reserves of the entire sterling area, the dominions would have to make equivalent import restrictions. For India and Pakistan, agreed quotas of dollars had already been established so that those countries had to adjust their dollar expenditure to the sum of a mutually agreed quota from the

30 ‘Australia and ERP’, 27 May 1948, CP286/2/1 bundle 32, AA.
dollar pool, their direct earnings of dollars, and their drawings from the IMF. The British chancellor suggested that a ‘target figure’ might be established for Australian drawings from the pool. Chifley, however, rejected this proposal and emphasised that Australia desired to continue to operate on the basis of the existing and informal ‘gentleman’s agreement’. Cripps accepted this position, and assured Chifley that Australia had the right to draw on its sterling balances above the frozen £125 million limit. Chifley did not, however, press the question of how far the United Kingdom would be able to supply goods against those balances.  

Cripps told Chifley that in pursuing the policy of avoiding drawing down the central reserves during the ERP period, the United Kingdom had sought to persuade the Americans to make provision for the deficits of the countries in the rest of the sterling area in the ERP allocation to the United Kingdom. The British had succeeded in overcoming the hostility to the sterling area which existed in the minds of the Economic Cooperation Administration (ECA). This was the United States government agency which administered the European Recovery Programme. The ECA informed the British that while they would now like to make some provision for the rest of the sterling area, they were precluded from doing so by the terms of the ERP act. Cripps told Chifley that if the Americans would not agree to provide for the rest of the sterling area deficit within the ERP allocation to the United Kingdom, he would approve of Australia seeking to obtain off-shore purchases from ERP recipients other than the United Kingdom. Chifley then asked whether it would be beneficial to the pool and to Australia if Australia were to divert commodities saleable for dollars away from the United Kingdom to North America, thereby increasing the United Kingdom’s import requirements from the USA, increasing the ERP allocation to Britain, and reducing Australia’s own dollar deficit. But Cripps replied emphatically in the

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32 ‘Notes on London discussions, July 8 – 13 inclusive’, by F.H. Wheeler, 2 August 1948, CP 286/2/1 522, AA.
33 The British did not want Marshall dollars to finance the purchase of basic foodstuffs and primary products from Australia since that would interfere in existing sterling area arrangements – bulk contracts, and the Australian wool auction system.
negative. He pointed out that the ERP allocation to Britain would be insufficient to cover its import needs, so it desperately needed Australian products. The United Kingdom was obliged to adjust its dollar deficit to whatever ERP allocation it was possible to obtain. It was not in the position of being able to adjust its ERP allocation to its dollar deficit. So instead of trying to divert Australian exports to the United States Chifley made long term contracts to supply the British with Australian meat and dairy products. In return he received assurances from Cripps that recent bilateral agreements concluded by the United Kingdom with other countries would not result in a reduction of supplies to Australia, particularly of key commodities like tinplate.34

Cripps concluded the discussion by giving Chifley an appreciation of the long–term nature of the dollar problem. He predicted that at the end of the ERP period in 1952 the United Kingdom would be able to sell overseas 145 per cent of its 1938 volume of exports. But, because of its loss of overseas investments and invisibles in the war, Britain would still only be able to import seventy–five per cent of the 1938 volume of imports. And there would still be a dollar deficit of about £100 million or $400 million per year when Marshall aid dried up. Cripps did not think it would be realistic to look to the United States to remedy this trade imbalance by buying more from the sterling area. So the only possible long term plan was to continue to divert to sterling area sources of supply and away from dollar sources. Chifley accepted the view that the long term solution to the dollar problem was expanded production and trade within the sterling area. Chifley was as always motivated by the desire to make the vulnerable Australian economy secure from depression.35 His long term plan for Australia was not, as Beresford and Kerr suggest, to become an American satellite, but to stick with the sterling area. Despite the sterling area’s weakness, British Commonwealth statesmen would at least participate in international collaboration and state planning to overcome common economic problems. The Americans, despite

34 Ibid.
35 Ibid.
making some progress, were still dominated by a rigid and inflexible interpretation of multilateralist liberalism.

When the Americans reviewed the case for financing the deficit of the rest of the sterling area with Marshall aid, they criticized Australia on two main grounds. First, they argued that because Australia was accumulating sterling balances, it was embarrassing the United Kingdom by adding to its debt liabilities. They thought that Australia could afford to contribute more to European recovery by making sterling loans or grants. Secondly, the Americans argued that because Australia financed its deficits with North America by drawing on the sterling area dollar pool, it was being a burden on the United Kingdom. 36 The Australians replied by arguing that they had actually helped the United Kingdom by accumulating sterling balances. The only way they could have embarrassed the United Kingdom would have been by using up sterling balances to buy British goods instead of paying for these British imports with the foodstuffs and raw materials which the British needed. They pointed out that Australia had international balances of £262 million. Of these the Australians were resolved not to draw on £156 million because of undertakings given to the British in 1947. This amount was invested in low interest bearing securities and was in effect a loan to the United Kingdom government at the rate of 1/2 a per cent. Balances of £78 million had accumulated since June 1947 but the Chifley government argued that it needed these reserves for three reasons. First they were a reserve against a heavy fall in export prices or drought. Secondly, they were a cushion against the fluctuations in price of Australia’s major exports. Without the cushion of London funds, the flow of imports into Australia would be subject to the same fluctuations as the prices of its staple exports. And thirdly they were needed to meet the interest on Australia’s overseas debt. Despite the existence of substantial London funds, Australia was in fact a considerable debtor to the United Kingdom. Australia’s total external sterling debt,

36 Telegram 709 Treasury to Wilson, 5 August 1948, CP 286/2 5221 Part 24, AA.
representing money borrowed in past years for Australia's development, stood at about £500 million, carrying an annual interest obligation of about £17 million.37

The Chifley government claimed that the American argument that Australia's accumulation of sterling balances would compel the United Kingdom to make unrequited exports to Australia at a later date, put the matter the wrong way around. It was Australia which was making unrequited exports now by continuing to export goods to European countries which were unable to provide Australia with all the imports she needed. Repayment at a later date of accumulated balances would perhaps involve Europe making unrequited exports to Australia then, but this was in no way different from the unrequited exports from Europe to the United States arising from interest payments on American loans.

As for the argument that Australia was a burden on the United Kingdom because it drew from the dollar pool, the Australians replied that this was false thinking. They admitted that Australia was a net drawer on the pool. But they argued that they were also supplying at low prices to the United Kingdom food which they could be diverting to the American market. Australia's power to earn dollars was reduced by these arrangements, but the United Kingdom, and the sterling area dollar pool, were saved dollar expenditure. The Australians pointed out that their dollar expenditure was restricted almost entirely to goods essential for production. Among the goods that Australia had to buy from the dollar area to keep up its production were industrial and farm machinery, tinplate, and timber. By making available to Australia the relatively small amount of dollars needed to cover its dollar deficit, the Americans would be assuring the United Kingdom and western Europe of continuing to receive from Australia a very much greater volume of essential foodstuffs and raw materials. If on the other hand Australia were forced to live within its dollar income, its ability to assist

37 Ibid., 'Annex to memorandum on Australia's position in relation to European Recovery Programme and dollar shortage', 6 August 1948.
in the economic rehabilitation of western Europe by continuing to export raw materials and foodstuffs would be greatly injured. 38

At the time of Chifley's visit to London, Australia's economic future was bleak. There seemed little hope that ERP aid would provide for Australia's dollar deficit, which meant that the Australian economy would be starved of essential dollar goods. 39 Australia might not any longer be allowed to draw dollars from the pool. Furthermore, Australia was being pressured by the Americans to make its own grants to assist European recovery. Chifley's policy was that if grants had to be made, they should appear as measures to help the United Kingdom on that country's request, and not as the result of American pressure. 40

The conflict between the American idea of integrating the United Kingdom into western Europe and dismantling the sterling area, and the British commitment to preserving the United Kingdom's role as banker to the sterling area, was brought to a head in August and September 1948. The British told the Americans that they could not possibly meet both the demands of European countries for the sterling credits they needed to finance essential purchases from the sterling area, and the demands of the countries in the rest of the sterling area (RSA) for the dollars necessary to finance essential imports from North America, without exhausting their reserves. Because of the 'legislative history' of the ERP act the Economic Cooperation Administration could not make a direct grant to the United Kingdom to cover the RSA deficit. Congress simply would not agree to Britain using part of the pool of dollars granted strictly for the purpose of financing American imports to Europe, for the purpose of covering the deficit of the countries in the rest of the sterling area. If that were permitted, it might slow down the pace of British recovery, reduce British imports

38 Ibid.
39 The European Recovery Programme covered Ireland, Iceland, and the United Kingdom as well as Britain's dependent overseas territories. The rest of the sterling area included South Africa, India, Pakistan, Burma, and Ceylon, Australia, New Zealand, Southern Rhodesia, and Iraq.
40 Telegram 2915 Chifley to Wilson, 4 August 1948, CP 286/2 5221 Part 2 Bundle 24, AA.
from ERP countries, and foil plans to build an integrated economic order in western Europe. There was a strongly held view in sections of the United States government that Britain overrated the economic importance to itself of the sterling area and that Britain would do much better by making up its mind to integrate at once with western Europe. 41

However other parts of the administration appreciated that the sterling area was the world's largest multilateral trading system. They predicted that denying the RSA's dollar needs would dislocate the economies involved and thrust additional defence and relief burdens onto the United States. And the Americans were now gradually coming to understand, as the Australians and British never tired of repeating, that to deny the dollar needs of the rest of the sterling area would impede the flow of goods from the RSA to western Europe. In July, therefore, the Economic Cooperation Administration developed a solution. They would give the United Kingdom an extra $169 million with which to provide for the dollars needed by the rest of the sterling area. In return the United Kingdom and the rest of the sterling area would grant the sterling equivalent of about $200 million to the continental European countries participating in the Marshall plan, to provide for their needs for sterling to buy goods from the sterling bloc. 42 But in return, the Americans wanted the RSA countries, and particularly Australia, to continue to restrict dollar imports, to draw dollars from the IMF rather than from the Bank of England, to fund their accumulated sterling balances, and to extend grants in aid for European recovery. 43

Some of the elements of this plan were extremely galling to Chifley. He had already voluntarily agreed to freeze £125 million of Australia's sterling balances. Now he was being asked to tie up what was left of Australia’s accumulated sterling in long term loans to Britain. He did not want to have to borrow from the IMF except as a last

42 Telegram 359 from Commonwealth relations, 25 August 1948, CP 286/2/1 522, AA.
43 Hogan, op. cit., p.172.
resort. He recognised the force of the American argument that if Australia had a favourable balance of payments in the future, it might consider further aid to Europe over and above its aid through United Nations agencies. But he wanted that to be an unfettered and spontaneous decision of the Australian government. Moreover he did not think that assessing Australia's contribution to European recovery at the sterling equivalent that Australia drew from the empire dollar pool bore any relation to Australia's capacity to give aid. Australia's dollar deficit in 1948/9 and future years might not be less than $60 million annually and he could not contemplate making annual grants of sterling to Europe on that scale. And lastly the American proposal tied the method of financing Australia's dollar deficit to American arrangements and decisions about ERP which were uncertain and unpredictable. It invited American scrutiny of Australia's dollar arrangements, gave Australia no more dollars than it had at the moment, but implied a commitment throughout the ERP period to make further substantial grants to Europe. 44

The American demands stalled the negotiations between Cripps and the Americans for a while. But in the meantime Chifley pre-empted a direct American request for Australia to contribute to the Marshall plan by unilaterally announcing a gift to the United Kingdom of £A10 million or $32 million. Chifley's public announcement of the gift recalled that many European participants in the ERP programme were practically as short of sterling as they were of dollars and that it had become urgently necessary to find some means of financing their sterling deficit so that they might maintain their purchases from the sterling area. He observed that the United Kingdom and the United States were engaged in discussions on the question. And he argued that Australia stood to benefit from any measures which assisted the external buying power of European countries. Since in the previous year Australia had had an overall favourable balance of payments and an increase in London funds, he announced a direct grant to the United Kingdom of £A10 million. The announcement of the grant

44 Telegram 723 Watt to Wilson, 11 August 1948, CP 286/2/1 522, AA.
by Australia broke the deadlock in the negotiations between the Americans and the British and the Americans agreed to finance the dollar deficit of the rest of the sterling area. They did not insist on the condition that Australia fund the remainder of its sterling balances and cease drawing from the dollar pool.\textsuperscript{45} This compromise was the basis of the intra-European payments plan.

In October 1948 the United Kingdom government convened a Commonwealth prime ministers’ conference to deal, among other things, with the Marshall programme and the dollar shortage. The British government predicted that Europe would have gone a long way to full economic recovery by 1952, but still the volume of imports coming into western Europe was unlikely to be above the pre-war level. Moreover a considerable increase of exports out of western Europe would be necessary to purchase even this volume of imports, given the loss of income from invisible transactions – shipping, insurance, investment. And by 1952 trade between eastern and western Europe would be considerably less than pre-war, thus reinforcing the continued dependence of western Europe on the United States for food and raw materials. This underscored the fundamental British criticism of the Marshall plan: that simply restoring western European production was not enough to make western Europe economically self-sufficient. What was needed was that the Americans purchase more of the raw materials and primary products of the colonial dependencies of the western European nations. In this way the western European nations could get the extra dollars needed to buy essential supplies from the United States which they could not pay for even from fully restored European production. The British predicted that the United States, which was contributing over £1000 million in ERP aid alone in 1948/9, would not be lending abroad at all in the 1950s. Even assuming a high level of activity and demand for imports in the United States in the 1950s, and considerable recovery in Europe, the British did not think that the western European and sterling area countries could achieve a balance with North America after ERP,

\textsuperscript{45} Unnumbered telegram from the prime minister, 31 August 1948, CP 286/2/1 522, AA.
without continuing import restrictions. Because of this the British predicted that
western Europe would maintain a high demand for sterling area primary products,
particularly as substitutes for North American goods. And the degree of restrictions
which the United Kingdom and the dominions would have to impose on dollar goods
after Marshall aid, would depend not only on relative cost levels in the sterling area
and the United States, but also on the level of United States demand for both
manufactures and primary products such as wool, rubber, tin, and cocoa, imported
from the Commonwealth. 46

The British argued that because the dollar shortage was likely to persist into the
1950s, it was unlikely that sterling could be made convertible, at least in the next ten
years. The British would of course maintain multilateralism within the sterling area
but they were uncertain about the relationship between the sterling and dollar worlds.
They would only go so far as to say: ‘an attempt will certainly be made to avoid a
complete bilateralism [with the dollar world], but there are limits to the extent to which
this can go.’ 47 The British provided a more particular assessment of the implications
for Commonwealth countries of the Marshall plan. A report to the Organisation for
European Economic Cooperation (OEEC) about the United Kingdom’s four year
economic recovery plan predicted that if the British could manage to sell 150 per cent
of their 1938 exports abroad, they could viably import at 80 to 85 per cent of their
pre-war level. To deal with the dollar shortage the British would have to rely more on
sterling than dollar sources of supply and increase the sterling area’s earnings of gold
and dollars. The prediction that the United Kingdom’s economic policy would be
viable was, however, based on four risky assumptions: that there would be no
American recession, that there would be no general rearmament, that adequate ERP

46 Minutes and memoranda of the Commonwealth prime ministers’ conference – Annex G, the world
economic position in 1952–3, September 1948, CRS A5954/1 Box 1790, AA.
47 Ibid.
aid would be received in the next three years, and that European economic cooperation would be a success.\footnote{Minutes and memoranda of the Commonwealth prime ministers' conference – Annex C implications for Commonwealth countries of the European Recovery Programme, September 1948, CRS A5954/1 Box 1790, AA.}

The British would have been forced to carry out something in the nature of the four year economic plan, even without Marshall aid. The importance of Marshall aid was that it gave Britain time to put through such a programme without having to suffer a disastrous fall in employment and living standards throughout the whole sterling Commonwealth. The British reported how under the European Payments Scheme, American aid had been conditional on the United Kingdom making available an equivalent amount of aid to debtor countries in western Europe. These countries had the sterling equivalent of $500 million with which to buy sterling goods. The British tried to put to rest Australian fears that because of British commitments to western Europe under the European Recovery Programme and in connection with bilateral agreements with other countries, the United Kingdom would be unable to supply the dominions with essential supplies and particularly capital. They argued that the sterling credits provided to the OEEC countries did not give them any claim on specific British goods, and that the $500 million worth of sterling credit had been based on a realistic assessment of what level of trade could be borne between the OEEC countries and the sterling area as a whole.\footnote{Ibid.}

The Australian government was represented at the Commonwealth prime ministers' conference by the deputy prime minister and minister for external affairs, H.V. Evatt. Evatt pointed out that Australia was looking to the United Kingdom as its most important market. Yet the British were not planning any increase in their overall purchases from overseas by 1952 and no increases in their future purchases from Australia. Evatt suggested that if the United Kingdom bought more from Australia than their present estimates justified, Australia's international income would be higher,
and Australians would as a consequence spend more abroad. Australians would spend most of this international income in the United Kingdom and to the extent that it was spent in countries like France and Belgium it would promote the reconstruction of western Europe. The only problem was that greater expenditure by the United Kingdom on Australian goods would cause Australians to spend more heavily in the dollar area. Evatt argued that sterling area import restrictions would take care of this problem.

He also questioned the British assumption that the western European countries would be in a position by 1952 to make all the purchases they wanted from the sterling area. If that were not so, the alternatives were that the Commonwealth would have to provide continued sterling aid to them, or the western European countries would have to impose import restrictions against the sterling area. Evatt hoped that the problem could be solved by countries outside the sterling area and western Europe, such as eastern Europe, earning surplus sterling. The western European countries, through trade with eastern Europe, could then earn enough sterling to make all the purchases they wanted from the sterling area, purchases which they would not otherwise have been able to make. Evatt declared:

We would be anxious to see even greater energy being devoted to the restoration of trade and building of new trade between western Europe and other parts of the world outside the sterling area since we think that success in doing so is a necessary condition for re-establishment at high standards of living of multilateral international trade in the non-dollar world.

Evatt made a similar point in relation to trade with the United States. The United Kingdom professed to be in favour of the full restoration of multilateral trade, yet the United Kingdom economic plan assumed that there would continue to be import restrictions against the dollar area after 1952. Evatt pointed out that Australia was being asked to undertake the development of goods previously purchased from North America. He warned that insofar as this could be done for industries which were natural and economic to Australia, the government would proceed with them as part of its development programme. But in cases where production was of a kind which would
compete with normally cheaper supplies from dollar countries, the Australian
government did not want to embark on major developments without very precise long
term assurances as to the security of its markets in the United Kingdom. Evatt’s
remarks revealed a great deal of uncertainty about how the world economy would
develop. There could be a full restoration of multilateralism throughout the world if
the Americans acted to solve the dollar shortage. On the other hand the sterling area
and western Europe might be forced to insulate themselves from the United States and
set up as a non-dollar trading area. Australia could continue in its traditional economic
relationship with the United Kingdom or it could diversify its trade and economy
according to America’s global plans. There could be no doubt that the Chifley
government saw Australia’s economic future with the United Kingdom and the sterling
area rather than with the United States. 50

The Chifley Government and the 1949 Dollar Crisis

The Marshall Plan was moderately successful in 1948. In Britain, agricultural and
industrial production each rose by twelve per cent, and the dollar gap between the
United States and Britain was reduced by one third.51 Yet this improvement had not
occurred under multilateral conditions. Convertibility of sterling had been suspended
since 1947 and the sterling balances had not been scaled down. Moreover British
exports to the United States were still only one third of the imports received from the
United States. These sober facts caused the British cabinet’s economic policy
committee to remark in March 1949 that ‘unless we can greatly increase our exports to
Canada and the USA, we cannot become independent of ERP aid without a reduction in
our present standard of living.’ 52

50 Cablegram 3618 Evatt to Chifley, 13 October 1948, CRS A5954/1 Box 1790, AA.
to Chifley, 25 February 1949, CP 286/2 Bundle 31 611 Part 2 AA.
52 'Expansion of exports to North America', 29 March 1949, PRO PREM 8/1145 EPC(49)31 quoted in
A.J. Rotter, *The Path to Vietnam: Origins of the American Commitment to South East Asia*, Cornell,
1987, p.53.
However in the first half of 1949 the gains of 1948 were reversed. A recession in the United States led to a decline of American purchases of sterling area commodities at the same time as American exports to the sterling area were increasing. This recession caused the United Kingdom's reserves of gold and dollars to fall below £500 million ($2000 million) – the level of reserves which the British hoped to retain at the end of the Marshall aid period. In the three months from April 1949 a sharp deterioration occurred so that by June the United Kingdom's reserves had fallen to $1624 million. The net gold and dollar deficit of the sterling area as a whole in the same three months was $628 million. At this rate of decline, it was obvious that the entire sterling area reserve would soon be exhausted. The British government attributed this sharp decline to two causes: first, reduced dollar earnings from sterling area exports of goods and services to North America; and second, an expectation of devaluation of the British pound, causing Americans to delay their purchases from the United Kingdom and hasten receipts. The interesting thing about the 1949 dollar crisis, as Sir Stafford Cripps himself noted, was that only one third of the dollar loss in the second quarter of 1949 was due to a decline in British exports. Two thirds of the loss was attributable to a fall in dollar receipts for sterling area raw materials – such as Malayan rubber and tin, Indian jute, and Australian and New Zealand wool.

Chifley sent a personal message to Cripps in July 1949 outlining Australia's dollar position. Chifley told Cripps that the Australian government, having originally planned to import £A120 million from the dollar area in 1947/8, had limited Australia's dollar imports to £A82 million as a result of cuts made after the convertibility crisis. Despite these substantial dollar savings Chifley had still been obliged to draw $164 million from the sterling area dollar pool in 1947/8. In a personal conversation with Cripps in London in April 1949, Chifley had informed Cripps that the Australian government would try to restrict net drawings from the pool.

53 'Australia's commitments on dollar expenditure', 22 January 1950, CRS A571/2 49/1860 Part 2, AA.
54 Rotter, op. cit., p.55.
to $55 million in 1948/9. Chifley was reasonably confident of being able to limit Australia’s dollar import programme to the dollar equivalent of £ A57 million. But he lamented that Australia’s net dollar result would be swamped by fluctuations in the price of wool which Australia had no ability to influence whatever. In 1946/7 the value of wool exports to the United States had been £53 million. But in 1948 wool exports had fallen to £A29 million. And on the basis of slow wool trading in May 1949 Chifley predicted that the value of Australia’s wool sales to America in 1948/9 would be as low as £A26 million, and Australia’s total exports to the United States £A40 million. Chifley predicted therefore that Australia’s net drawings on the sterling area dollar pool in 1948/9 would be closer to $70 million than $55 million. 55

Because of disappointing wool sales to the United States Chifley had to draw down Australia’s sterling balances slightly more than expected in 1949. Consequently the American ambassador to the United Kingdom, Lewis Douglas, noted that one of the causes of the dollar drain was abnormal purchasing from America by India and Australia. But he attributed the dollar crisis mainly to the general diminution of American purchases abroad of important sterling area dollar earning commodities. The ambassador thought that when the British public came to realise that their gold and dollar reserves had fallen by one sixth in only three months, the shock might ‘throw the country into an economic as well as a financial crisis’. He predicted that a full scale economic crisis would develop in the United Kingdom and spread throughout the British Commonwealth some time after August. He suggested that the United Kingdom would respond by making drastic cuts in dollar imports, food consumption, and investment, shedding military and political commitments abroad, increasing the pressure on the sterling area to reduce the dollar drain, and tightening the bond between sterling and other soft currencies. He had been told that the United Kingdom government had developed a programme to prevent Britain from having to devalue sterling and he warned his government:

55 Draft message to the chancellor of the exchequer, 30 June 1949, CRS A571/2 49/1860 Part 1.
Since many other countries would be affected by a British collapse, it seems that the logic of the situation would compel Britain and other countries to move toward the development of at least a quasi-autarchic (sic) sterling area, embracing as many countries as will be brought or forced into it. Also, with the probable shrinking of trade with the dollar area, would not these countries eventually have to consider a reorientation of their trade toward eastern Europe and Russia?56

As Hogan has recorded, Cripps took charge of British policy in relation to the dollar problem. He outlined three alternatives for dealing with the drain on Britain's reserves. The first strategy was deliberately to create an economic autarky: a soft currency trading bloc composed of countries in the sterling area and western Europe, tied to sterling and sheltered by a wall of restrictions against dollar competition and swings in the American business cycle. This so called 'two world' policy divided the globe into three currency regimes (sterling, dollar, rouble) and the 'free world' into two. The objections to this policy were that it might drive Canada out of the British Commonwealth; it would result in more austerity for the United Kingdom and other members of the autarky; and it would result in less food imports for Britain, at higher prices, lower standards of living, and more unemployment. But the most important objection to the 'two world' policy was not economic but political and strategic. It would, in the words of a memorandum of Cripps in July, 'cut across the essential political and strategic requirements of the country as represented by the North Atlantic Pact, western union, and Commonwealth solidarity'. The simple truth was that Britain did not have the capacity to fight another major war without American assistance. It could not counter the Soviet threat without its American ally. Retreating into a policy of economic autarky would end Britain's partnership with the United States and end its status as a great power.57

Another of Cripps' strategies was to enter immediately into a one world system based on full convertibility and multilateralism. Yet although, as with Australia, multilateralism was the ultimate goal of the British, Cripps did not think that the weak

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56 The ambassador in the United Kingdom (Douglas) to the acting secretary of state, 16 June 1949, FRUS, Volume IV, 1949, pp.784–6.
57 Hogan, op. cit., p.239.
British economy was strong enough to be exposed to the full fury of an unregulated market which would bring unemployment and drastic cuts in social expenditure. This second alternative was no more appealing than the first to a government committed to economic planning and the welfare state. 58

The Chifley government was considering the same options as the British. In late June 1949, Chifley held a meeting with Evatt and Dedman, the minister for postwar reconstruction, to consider strategies for solving the dollar problem. Evatt blamed the United Kingdom's predicament on three factors: the recession in the United States; the disruption to trade between eastern and western Europe caused by American imposed restrictions on the sale of strategic materials to eastern Europe; and the development of competition with Britain from Japan and Germany resulting from measures taken by the United States to build up these economies and to integrate them in the western rather than the eastern orbit. Evatt wanted Britain and the Commonwealth to use international forums to persuade the Americans to take steps to overcome the dollar shortage by methods such as unilaterally lowering their tariffs, allowing the sterling area to discriminate against American goods, and buying and investing more in the sterling area. If the Americans would not agree to cooperate, he thought that there was a good case for the sterling area forming a 'self sufficiency group'. And he thought that the best chance of forcing America to cooperate was by threatening the formation of a non-dollar autarky and by threatening the political and economic accommodation of this autarky with the eastern bloc.59

While the Australian government was considering its policy towards the dollar problem, its treasury representative in London, J.F. Nimmo, supplied valuable information about British thinking. Nimmo reported that the British regarded the dollar situation as too serious to delay remedial action in the hope of further American

58 Ibid., pp.239–40.
59 Memorandum of conversation between Chifley, Evatt, Dedman, and Wheeler, in letter from Evatt to Chifley, 29 June 1949, Dedman Papers, MS 987/14/479–82 National Library of Australia (NLA).
assistance which in any case was unlikely to pass congress even if it were supported by 
the president and administration. He predicted that Cripps would ask the countries in 
the rest of the sterling area to reduce their dollar expenditure by a certain percentage 
of their 1948 dollar imports. And he thought that the chancellor would insist on the 
RSA countries meeting this figure even if it meant India, Pakistan, and Ceylon leaving 
the sterling area. The British were worried about the political effects of their demands 
on the Asiatic dominions, and so were ‘hoping that Australia and New Zealand [would] 
make magnificent gestures.’ 60

In the early days of July, the Chifley government framed a policy to be advanced 
at the Commonwealth finance ministers’ conference in London. It determined to raise 
the issue of freeing up trade between eastern and western Europe. Restrictions on east– 
west trade made western Europe more dependent on supplies from North America and 
thus more dependent on dollar aid. It also wanted to stop the United States from 
forcing Japan into the position of a competitive buyer and seller in the western 
economy. It proposed that the British Commonwealth countries should impress on the 
United States in international forums its responsibility to maintain full employment. 
And most controversially the Australian government decided to pursue the idea of 
participating in a non–dollar economic bloc. 61

One of Chifley’s economic advisers, Trevor Swan, told Chifley that on current 
British estimates, and allowing for ERP receipts of $800 million, the sterling area 
would go on to lose $900 million in 1949/50, taking British reserves to an all time low 
of $700 million. The sterling area countries would have to slash dollar imports by one 
third, by more than the ERP appropriation itself, to prevent such an outcome. Swan 
thought that the choice was either to devalue sterling in order to try to sell more to the 
dollar area, or to isolate the United States by a virtually worldwide system of 
discrimination against the dollar:

60 Nimmo to treasury, ‘Finance ministers’ conference’, 4 July 1949, CRS A571/2 49/1860 Part 1, AA. 
61 ‘London financial discussions’, 7 July 1949, CRS A4311 29/4, AA.
The fact is that no country which intends to maintain full employment and a relatively stable level of costs and prices can afford to do business with the USA on a large scale non-discriminatory basis, unless its gold and dollar reserves are sufficiently large for it to be able to ignore short term fluctuations (or there is an IMF that really does its job instead of "calling in the umbrellas when it starts to rain") – at any rate until some prospect of economic stability in USA begins to appear.\(^6^2\)

The Chifley government’s economic policy had always been to use deliberate cuts in imports, rather than unemployment, as the means of bringing down imports to a level at which Australia could pay for them. Another of its policies was to expand to the full mutual trade with other countries that pursued policies of full employment. However the United States thesis of non-discrimination carried the implication that countries suffering balance of payments problems should cut imports from all countries equally. Thus if a depression in the United States forced other countries to cut down purchases from the United States, they would have to restrict purchases from each other as well. The Australian government argued that such a policy was guaranteed to spread recession. It concluded, therefore, that the finance ministers’ conference should at least explore the feasibility of establishing a group of countries committed to maintaining full employment and high levels of demand, and prepared to trade freely with each other, even though obliged by lack of dollars to impose discriminating restrictions against United States goods – in short, a multilateral non-dollar world. This was envisaged as including countries in the sterling area, western Europe and Latin America.\(^6^3\)

On 8 July, Coombs suggested that Australia should induce the IMF to intervene in the dollar crisis. Coombs had no ‘two world’ proclivities and was worried that further discrimination and restrictions against the dollar would lead to the wholesale abandonment of multilateralism in favour of bilateralism. Australia would then be tied rigidly to United Kingdom economic policy, and its future overseas economic relations would be largely subject to negotiated arrangements with Britain. Chapter VII of the

\(^{62}\) ‘Notes on the dollar problem’, 5 July 1949, CRS A571/2 49/1860 Part 1, AA.

\(^{63}\) ‘London financial discussions’, 7 July 1949, CRS A4311 29/4, AA.
Bretton Woods agreement provided that if a general scarcity of a particular currency was developing, the Fund might issue a report setting forth the causes of the scarcity and containing recommendations to bring it to an end.\textsuperscript{64} According to Coombs, any objective report 'could not fail to bring out that the current US recession is an appreciable cause of the scarcity of dollars'. The recommendations designed to bring to an end the scarcity of dollars might throw responsibility on the United States government to reverse the existing trends in the American economy. They might even go further and urge the United States to conduct a greater import programme than before the recession developed.\textsuperscript{65}

The response to Coombs' suggestion by treasury and external affairs was unfavourable. Treasury replied that 'although the recent American recession has undoubtedly aggravated the position, it could not be argued that the recession itself is the basic cause of the dollar problem'. Moreover treasury thought that the Americans would influence the nature of any report prepared by the Fund, and would highlight excessive costs of production in the United Kingdom, Europe, and other countries, and the need for devaluation of their currencies, rather than the faults of American economic policy. External affairs concurred in this advice, arguing that the United States government recognised that there would be a contraction of its exports unless more dollars were distributed to the rest of the world. But unfortunately the Truman administration was placing its faith in a policy of devaluation of foreign currencies relative to the dollar and not a policy of increased imports, tariff cutting and loans.\textsuperscript{66}

The Australian Labor government had always insisted that the economic system envisaged at Bretton Woods would be workable only if certain basic conditions were fulfilled – with safeguards and sanctions to operate if they were not fulfilled. In July

\textsuperscript{64} See, \textit{infra}, p.19.

\textsuperscript{65} 'The International Monetary Fund and the scarcity of US dollars', 8 July 1949, CRS A571/2 49/1860 Part 1 AA.

\textsuperscript{66} \textit{Ibid.}, draft telegram to the Australian high commissioner's office – treasury to Coombs, Wheeler, and McFarlane n.d.; minute by H.R. Woodrow, 11 July 1949.
1949, as a memorandum of Dedman's pointed out, the chief danger which the Australians had in mind, an American depression, showed signs of developing. And there was no sign of the effective operation of any of the positive international measures, safeguards or sanctions on which the Australians were relying. The full employment and development clauses in the ITO charter and indeed the whole charter had been pigeon holed. Economic cooperation through the United Nations had almost completely failed. The United Nations Economic and Social Council was ineffective, moves in the European Economic Commission to promote east–west trade had broken down, and the Americans were even considering economic warfare in the form of a blockade of China. The IMF and the IBRD had stated in response to a UN questionnaire that they could do little to help in the event of an American recession. The American interpretation of the articles of the IMF effectively denied the use of the Fund’s resources to constituent members. And simultaneously the United States was determined that the dollar could not become technically scarce within the Fund, thus nullifying the scarce currency escape clause of the Bretton Woods agreement.67

Dedman's paper argued that the Chifley government could either accept as inevitable the breakdown of its foreign economic policy, or do what it could to protest and point out the remedies. To take the first option would be to leave the field clear to the United States to preach convertibility and multilateralism to the rest of the world, 'putting the responsibility for the basic adjustments necessary to this end (apart from the inadequate and temporary provision of ERP aid) upon other countries'. Dedman was anxious that the Commonwealth conference should not simply rubber stamp an Anglo–American reaffirmation of the objective of multilateralism and convertibility. He was doubtful whether an Australian protest would make any headway given the attitude of the United States and its dominant position in the world’s economic councils. But he suggested that the Australians could put their view to the British privately at the

67 'Australia's international tactics in relation to commercial policy and full employment', n.d. July 1949, Dedman Papers, MS 987/14/682, NLA.
Commonwealth conference. He also suggested that the Australians should recommend
the setting up of a special committee of the UN Economic and Social Council to advise
the General Assembly to revive Keynes' 'bancor' scheme, which provided
international credit on central banking lines to meet the threat of recession. Finally he
suggested that Australia could urge on the IMF and IBRD a more liberal use of their
resources. 68

Meanwhile the United Kingdom government was about to make a momentous
decision on how to deal with the dollar problem. The American ambassador in Great
Britain reported on 22 June that the British government, in its efforts to deal with the
crisis, would take many steps consistent with the creation of a protected autarkic
trading area centred on sterling. He was convinced, however, that a sterling autarky
could not provide a long term solution to the dollar problem. The dollar economy was
so important to the economic life of the western world, that it would be impossible to
isolate a sterling hegemony completely. He predicted that Cripps would defend the
British position initially by a sharp curtailment of dollar imports and that he would
strongly oppose devaluation of sterling. At the same time the United States executive
would demand devaluation. Ambassador Douglas was anxious to avoid an acrimonious
exchange in which the British blamed adverse developments on the American recession
and the United States blamed the British for socialist mismanagement of its affairs. A
break between the British and the Americans would prejudice the Marshall Plan,
damage the American economy, and defeat American political and strategic objectives
in Europe. Douglas therefore hoped for an amicable meeting between the Americans
and the British in July. And he wanted the Canadians to sit in: first, because if the
British opted for a sterling autarky, the Canadians would have to decide whether to go
with Britain or America; and secondly, because after taking part in the tripartite

68 Ibid., items 682-5.
discussions, Canada could act as ‘an amicus curiae’ in the subsequent Commonwealth finance conference. 69

The British government’s decision was to compromise. Cripps devised a policy which reconciled America’s commitment to multilateralism with British Labour’s adherence to the sterling area, and the welfare state. The British would limit government expenditure, improve productivity, and redirect exports to the dollar area. But in return the United States would have to bail the sterling area out. They would have to lower tariffs, continue aid programmes, help the British replenish their reserves and assist them in reducing the sterling balances. And in particular they would have to increase their stockpiling of sterling area commodities like rubber and wool, simplify customs procedures, waive the non-discrimination clause of the loan agreement, support IMF and IBRD loans to sterling area countries, and help to make commodity agreements to prop up the price of sterling area commodities. 70

The talks between the Americans, the Canadians, and the British, took place from 8 to 10 July. The American treasury secretary, John Snyder, advocated the orthodox remedy for a country with balance of payments difficulties: devaluation and deflation. Snyder’s view was that over full employment and a high level of budget expenditure, and the releases from the sterling balances were preventing the United Kingdom from producing at competitive prices and selling to the United States and third countries. 71

This was in direct opposition to the British approach. Snyder reported back to the secretary of state that ‘we now seemed to be facing squarely a fundamental difference between US and UK in approach to economic recovery and stability. In short, Cripps seems to want some kind of international state planning in a positive manner as a method of coping with recurrent dollar crises of UK’. 72 Snyder was incensed that

69 The ambassador in the United Kingdom (Douglas) to the secretary of state, 22 June 1949, FRUS, Vol. IV, 1949, pp.787–90.
70 Hogan, op. cit., p.240.
71 Telegram F9 Dedman to Chifley, 17 July 1949, CRS A571/2 49/1860 Part 2 AA.
72 The secretary to the treasury (Snyder) to the secretary of state, 9 July 1949, FRUS, Volume IV, 1949, pp.799–801.
Cripps would not consider devaluation except as part of a general plan that struck him as socialistic:

While they purport to be striving toward multilateral trade and non-discrimination, it is apparent that they consider attainment of these objectives to be subservient to requirement of maintaining stability and thus protecting rigidities not only of UK but, now, of sterling area as a whole. It is difficult to see how any fruitful results can be obtained so long as the British refuse to take fundamental steps which will shake out the rigidities and make their economy more flexible. However I believe that we can make use of forthcoming conversations to stress strongly that such steps are necessary if continued economic cooperation between our countries is to bear fruit.\(^73\)

After the exploratory talks were completed, the Commonwealth finance ministers' conference began. At a preliminary meeting of officials on 15 July, British treasury officers told the Australians that the British cabinet had debated the big question: would it be right to adopt as a deliberate matter of policy the idea of a two world economy? They reported that the British cabinet had rejected this policy. The British then gave the Australians a sketchy summary of their discussions with the Americans and the Canadians. They related that the British had brought home to the Americans that no solution to the dollar shortage could be made without a serious contribution from the United States. Nevertheless Snyder had insisted that that it was up to the United Kingdom alone to achieve multilateralism and convertibility by making its economy more competitive. Now that the British had rejected the two world idea with its emphasis on saving dollars, the approach had to be how to increase the sterling area’s ability to earn dollars.\(^74\)

Coombs for the Australians put forward the view that the British were approaching the dollar problem too narrowly. He agreed with the need to increase the dollar earning capacity of the sterling area but argued that the achievement of dollar 'viability’ for the sterling area necessitated re-establishing a trade pattern for the world as a whole. In other words the Americans not only had to assist western Europe

\(^73\) Ibid., p.802.
\(^74\) 'Officials' discussion of long term dollar problem’, 15 July 1949, CRS A571/2 49/1860 Part 2, AA.
but they also had to aid the sterling area and countries in the Far East and eastern Europe. They had to allow a broad pattern of trade and payments to develop between eastern and western Europe. 75 Coombs suggested that part of the problem was that the Americans were not investing enough in the rest of the world. In his view the IMF and the IBRD had failed to promote international investment and new mechanisms had to be established. He thought that the United States, which was a high cost agricultural producer, should do as Britain had done with the corn laws, and abandon agricultural protection. He thought that the Americans were paying too much attention to lowering the high cost of commodities in the soft currency areas, and not enough attention to maintaining total world demand. In Coombs’ view, the Americans should first establish the prior conditions for multilateralism to work – by restoring full employment and investing in and purchasing more from the rest of the world – before the British Commonwealth could even consider devaluation.76

The conference opened on 13 July. Cripps reaffirmed that multilateralism was still the long term goal of the United Kingdom although in the short term it had to consider measures to increase dollar earnings and reduce the drain on reserves which might be contrary to the spirit of multilateralism. Canada played the role of friend of the Americans. The Canadians were adamant that the political and security aspects of relations with the United States should determine the British Commonwealth’s policy to the dollar problem. They maintained that the acute dollar crisis of 1949 could not be blamed on the American recession and that the Americans could not be expected to fuel inflation in their own country in order to help the dollar position of other countries. They also challenged dollar cutting which would have the undesirable effect of

75 Dedman made the same point to Cripps. Cripps told Dedman that it was vital to change economic fundamentals to achieve multilateral trade in the whole world outside Russia. Dedman argued that multilateral trade should extend to the whole world including Russia. 'Discussion at lunch between Coombs, Dedman, and McFarlane on 13 July 1949 CRS A4311 29/4 AA.

76 ‘Officials’ discussion of long term policy’.
creating an insulated high cost sterling area. The New Zealand delegation was typically and uncritically loyal to the British position.\(^77\)

But Dedman went to the heart of the problem. He joined the United Kingdom in affirming Australia’s commitment to multilateralism. As he later told Chifley, although he could not feel confident of the Americans taking adequate action to alleviate the dollar shortage, ‘in view of the United Kingdom judgement on the situation, and of Australia’s great interest in multilateral trading, we [did] not wish to recommend that Australia urge that pursuit of the multilateral objective be abandoned’. \(^78\) But he wondered how discrimination in the short term could be reconciled with multilateralism in the long term. He suggested that multilateralism could only be achieved if the Americans undertook to reduce tariffs, increase investment in backward areas, especially in Asia, and assisted the expansion of aid between eastern and western Europe. He suggested that the British should put this to the Americans at a special economic conference about the dollar problem in September, and urged the British to lay before the conference the exact line that they would take there.\(^79\)

The British would not give details of the approach they would take with the Americans in September. They merely stated six lines along which they would explore a solution. Surplus countries should open their markets to the exports of deficit countries. The reserves of deficit countries should be protected. Non–dollar countries should try to achieve relatively comparable costs with dollar countries. Dollar countries should pay reasonable prices for the staples of the sterling area. Full employment should be maintained, especially by surplus countries. And American investment overseas should be encouraged.\(^80\)

\(^77\) Telegram 1, Dedman to Chifley, 13 July 1949, CRS A1838/1 708/12/1 TS, AA.
\(^78\) Telegram F9, Dedman to Chifley, 17 July 1949, CRS A4311 29/4, AA.
\(^79\) Telegram 1, Dedman to Chifley, 13 July 1949.
\(^80\) Ibid.
Dedman cabled Chifley that the United Kingdom had submitted to the conference the first draft of an agreed conclusion on the long term economic objective of the British Commonwealth. The draft declared that the British Commonwealth welcomed the discussions with the Americans in July and their continuation in September. And it endorsed the objective of multilateral trade at 'high' levels of employment. Chifley cabled back that the resolution impressed him as an attempt to temper the British announcement of unpalatable dollar import restrictions by reassuring the Americans that the British Commonwealth was pursuing the same broad economic objectives as themselves. Chifley did not want to give a blanket endorsement of what the British, Canadians, and Americans decided by themselves about the dollar shortage in September, so he urged that the conference should merely 'note' and not 'welcome' the results of the tripartite conferences. He urged Dedman to try to amend the agreed conclusion by incorporating Australian ideas on such matters as east-west trade, assistance to the countries in the rest of the sterling area, and more American investment in the rest of the world. But he warned against making the resolution too controversial:

You will of course have well in mind that Australia may have to engage in direct negotiations with banking agencies of the United States government for financial aid and that these negotiations might be influenced by attitudes on broad international policy as evidenced in the resolution of this conference.81

The final communique of the conference was a bland statement that the Commonwealth's aim was the establishment of a single multilateral system in which dollar and non-dollar countries could operate together. The communique did not go in to how multilateralism could be achieved except to say that sterling area countries needed to reduce their costs of production, bring inflation under control, and bring claims upon their productive resources into line with the reserves available to them, including external borrowing. To avoid further drain on the sterling area's reserves

81 Cablegrams F2, F3, and F7, 15, 16, 17 July 1949, CRS A1838/1 708/12/1 TS AA.
the finance ministers agreed to recommend to their governments to cut their imports of dollar goods by 25 per cent of dollar imports in 1948.82

On 4 August Nimmo provided Chifley with his assessment of the conference. He was shocked that the British cabinet had considered pursuing an economic policy consistent with two trade areas. He told Chifley that Cripps had championed the two-world policy against the foreign secretary, Ernest Bevin, who regarded the preservation of the Anglo-American alliance against the Soviet Union as paramount. Nimmo thought that the two-world policy had been rejected for strategic and political reasons rather than economic reasons and that the British might yet revert to a two-world policy if backed into the corner by the Americans. He argued that a two world concept, if passively accepted, would result in a standard of living in the sterling area countries much lower than under existing sterling area arrangements. The fact that the British cabinet had considered this policy suggested two things to him: first, that the British regarded the dollar problem as so deep seated that a solution was unlikely to be found in the near future; and secondly that Britain expected to remain the principal and essential market for the exports of the sterling area countries.

Nimmo argued that the United Kingdom’s decision to ask sterling area countries to cut their dollar imports by 25 per cent was in practice a demand that independent RSA countries, including Australia and New Zealand, should live within their dollar incomes and become net contributors to the pool. He thought that the British would be hard on the Australians whichever way they went. If they continued to opt for a one-world system, Australia’s drawings from the pool would impede Britain’s progress towards European integration and multilateralism. And if they changed to a two-world system the British would enforce on Australia the same dollar austerity which they themselves endured. On the assumption that there would be no decline in American purchases of wool, and on the assumption that Australia managed to cut its dollar

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82 Ibid., Cablegram F12 Dedman to Chifley, 18 July 1949.
deficit by 25 per cent of the 1948 figure in 1949/50, Australia was still likely to incur a
dollar deficit. Nimmo asserted that such an outcome was unlikely to satisfy the United
Kingdom and that Australia should be prepared for an ultimatum stating that Britain
would not sell Australia dollars after 31 December 1949. And even if Australia
achieved a dollar balance in 1949/50, there was the possibility that Britain would ask
for further sacrifices, not only in more restrictions of dollar imports, but also in terms
of Australian costs and the structure of future production. He concluded:

Faced with a most nebulous future, are we wise in continuing to emphasise,
as we have done in the past, that each successive intensification of our
dollar import restrictions is necessary to assist the United Kingdom and to
justify our continued membership of the sterling area dollar pool? There is
likely to come a time when, even though we are in political and strategic
harmony with the United Kingdom and we still recognise our moral
responsibility to continue to make economic sacrifices in return for past favours (ie drawings on the dollar pool), we must face up to obligations to
our own people.\(^{83}\)

McFarlane wrote to the prime minister that:

the dollar cuts can no more than limit the drain on reserves when they take
full effect and the long and medium term proposals are too vague to
produce any feeling of confidence in the future. The official communique
was weak and likely to be interpreted as such by the Americans.

McFarlane thought an economic *rapprochement* between the United States and United
Kingdom unlikely. In his view the United Kingdom had to produce some tangible steps
towards competitive costs and greater exports to North America. One such step would
be devaluation of sterling, which would have the effect of making sterling area exports
cheaper for Americans. But the problem with devaluation in a fully employed
economy was that it would cause inflation and redistribute income from the wage
earning sector to the exporting sector of the economy. McFarlane also thought that
even if the British managed to persuade the United States administration to take action
to improve the dollar shortage, Congress was unlikely to agree.\(^{84}\)

\(^{83}\) 'The finance ministers' conference, July 1949', 4 August 1949, CRS A571/2 49/1860 Part 2, AA.

\(^{84}\) McFarlane to Chifley, 25 July 1949, CRS A571/2 49/1860 Part 2, AA.
Similarly F.H. Wheeler of treasury thought that the conference was an anti-climax. He felt that the United Kingdom had 'strong doubts as to its ability to preserve the aim of multilateralism'. And he thought that the British had no idea of what the British might do to help and no firm idea of what they should ask for. He considered that the general outlook for the economic talks in Washington in September was not helpful and that the British were underestimating the drain on reserves which would in the future be caused by speculation on devaluation.85 A.H. Tange of external affairs thought that two considerations underpinned the recommendations of the conference. The first was the low level of reserves and the heavy demand on them. The second was the decision of the British government, for political and strategic reasons, to avoid a dispute with the United States on long term trade policy. He concluded that the dollar crisis would be a recurrent one, with no solution in sight. It all seemed to depend on the willingness of the United States to expand, very considerably, its international lending and to increase its overseas purchases through domestic employment, tariff, and other policies.86 And Trevor Swan of the prime minister’s department concluded that the existence of the sterling area depended on the outcome of the Washington economic discussions.87

The 1949 dollar crisis, like the 1947 convertibility crisis, instigated a review of whether Australia should remain with the sterling area dollar pool. The treasury argued that two main considerations made it advantageous for Australia to remain with the sterling area: first its large holdings of sterling balances; and secondly the pattern of its trade. In 1949 Australia’s sterling balances stood at over £400 million. If Australia were to withdraw from the sterling area system, divert its trade to the dollar area, and perhaps relax its import licensing system, Australia’s sterling balances would become blocked balances available only for payments to sterling countries, except with

86 A.H. Tange, Report on meeting of Commonwealth finance ministers, 2 August 1949, Evatt Papers, Box 448, external affairs file, CRS A4311, AA.
87 'The London financial conference', 24 July 1949, Dedman Papers, MS 987/14/678, NLA.
the express permission of the British government. Such permission could not be expected where 'hard currency' payments were involved. Australia thus had the strongest interest in supporting sterling and assisting in its convertibility, if only as a means of protecting its reserves.

The second reason was the historic pattern of Australia's trade with the United States. Australia had only earned a surplus of dollars in the second world war under abnormal conditions. Australia's net dollar deficits pre-war and postwar were:

Table 2.1 – Australia's Dollar Deficits

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<td>1936/7–1938/9</td>
<td>9.2</td>
<td>35.9</td>
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<td>(three year average)</td>
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<td>1946/7</td>
<td>16.9</td>
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<td>1947/8</td>
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<td>1948/9</td>
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Without the dollar pooling system, imports from dollar countries would have had to be cut to a level which could be financed from Australia's own dollar resources. It had on occasion been suggested that Australia would fare much better outside the sterling area, diverting its trade away from the United Kingdom to the dollar area. The treasury view was that this suffered from three defects. First, it would entail sacrificing secure long term markets, for the sake of possibly temporary and unstable markets in North America. Second, even if Australia pushed such a trade diversion policy to the limit, it was unlikely that she would be able to earn enough dollars to finance the level of dollars which she was able to get within the framework of the dollar pooling system. And third, most decisively, a trade diversion policy would be a two edged sword. Australia was already purchasing many essential goods in short supply from the sterling area, and being relieved of the necessity of purchasing them from North America. If Australia were to go it alone, the United Kingdom would be
less willing to supply Australia with those scarce commodities, thus making herself even more dependent on dollar goods.\textsuperscript{88}

Faced with a choice to stick with the sterling area, or forge a new economic relationship with the United States, Chifley chose the former policy. On 19 August cabinet decided to reduce Australia’s demands on dollar imports by roughly the same proportion as the cuts already announced by the United Kingdom. \textsuperscript{89} Kim Beazley later recorded:

I well remember the late Mr Chifley, when asked by me why he was so adamant in his refusal to borrow from the United States of America, stating that he believed that all the capital equipment required by the country could be obtained within twelve months if the sterling balances were held and we waited for British recovery.\textsuperscript{90}

\textbf{Conclusion}

This study of the Chifley Labor government’s international economic policy after the convertibility crisis of 1947 shows that Chifley’s economic strategy was not leading, as Beresford and Kerr argue, to the ‘cutting of the apron strings which tied Australia to a declining British empire…and to the reorientation of trade flows and capital intake towards the increasingly powerful American economy’.\textsuperscript{91} The reverse was true. Australia’s economic relationship with America worsened in the three years after 1947. In 1945–6, Australia took three per cent of America’s wartime annual exports, whereas it only took one per cent in 1948–9. At the same time Australia’s relationship with the United Kingdom strengthened. Britain still took about forty–two per cent of Australia’s exports in 1948–9 and the percentage of its total imports which Australia took from the United Kingdom improved from forty–one per cent in 1938–9 to about fifty per cent in 1948–9.\textsuperscript{92} Chifley’s pro–sterling area policy was a reaction to the American dollar shortage and the threat of depression. After the convertibility crisis,

\textsuperscript{88} ‘Australia and the sterling area dollar pool’, 17 August 1949, CRS A571/2 49/1860 Part 2, AA.
\textsuperscript{89} \textit{Age}, 20 August 1949.
\textsuperscript{90} \textit{CPD}, Vol. 217, 7 May 1952, p.92.
\textsuperscript{91} Beresford and Kerr, \textit{op. cit.}, p.144.
\textsuperscript{92} Gregory Pemberton, \textit{All the Way, Australia’s Road to Vietnam}, Sydney, 1987, pp 1–2.
Chifley cooperated with the United Kingdom in trying to reduce Australia’s dependence on dollar goods and switching to sterling area sources of supply. Chifley resolved that Australia would be developed primarily from Australian and British investment and that Australian trade would be mainly with the sterling area. Because of the dollar shortage he did not want Australia to become dependent on American loans and American capital or to develop new markets in the fickle and unstable United States economy.

It seemed to Chifley’s cabinet in 1948 and 1949 that the international economic system established at Bretton Woods had collapsed. In response, the Americans had developed the Marshall Plan of dollar aid to western Europe as a way of reconstructing a multilateral world economy. But the Marshall Plan, in turn, sank under the weight of the dollar crisis in the United Kingdom and the sterling area in 1949. The United Kingdom’s economic solvency depended not only on the revival of production in western Europe but also on consistent American purchases of sterling area raw materials like rubber, tin, and wool. And Australia’s economic security depended on the recovery of the British economy. By the middle of 1949 the sterling area was in even worse shape than 1947. But Chifley’s government resolved to remain with the sterling area: Australia would ride out the depression which was threatening in America with the sterling area as a protective shield. The best the government could do was to hope that the Americans and British would come up with a plan in September to solve the problem of the dollar shortage. Otherwise the depression which had long been threatening would unleash itself upon the world.
The Chifley government regarded the implications of the dollar shortage and the threat of depression as the most serious long term problem confronting Australia, concluding that it had to give priority to Australia’s economic development and to preserving full employment without inflation. This would be an immensely difficult task considering its belief that the dollar shortage would be a permanent and intractable problem which posed a threat to the very existence of the sterling area and Australia’s traditional trading relationships. The government did not believe that the threat of international communism was of the same magnitude as the economic problems associated with the dollar shortage. Its foreign and defence policy was based on the assumptions that upholding the authority of the United Nations gave the world the best chance of preserving peace and that East–West rivalry, in the end, would not result in another war. Moreover Labor’s defence policy after the war was regional rather than global. After Japan’s conquest of South East Asia in the second world war, the Labor government was extremely reluctant to commit itself to support once again the United Kingdom’s strategic policy in Europe and in the Middle East at the expense of the security of the Pacific region. Labor’s foreign policy was internationalist and its defence policy regional. The Liberal and Country parties sharply disagreed with Labor’s policies: they had little faith in the ability of the United Nations to preserve peace; and they wanted Australia to rely for its security on the global strategic plans of the United Kingdom and the United States.

Australia’s foreign policy in the forties was presided over by Herbert Vere Evatt. Born in 1894, Evatt was a graduate of Sydney university. A barrister and Labor member of the New South Wales parliament in the 1920s, he became the youngest appointment to the high court in 1930. In an unprecedented move he resigned from the high court to contest the federal seat of Barton in 1940, and on the accession of John
Curtin to the prime ministership, he became simultaneously attorney-general and minister for external affairs. As described by contemporaries, Evatt was brilliant, egotistic, immensely hard working and cantankerous. He was determined that small nations such as Australia should have a voice in the world’s councils, and that the pre-war system of unrestrained state rivalry should give way to a more rational world order based on internationalist liberal principles. Evatt’s faith in these principles became even stronger as a result of his election to the presidency of the General Assembly of the United Nations in 1948.  

The determination of Australian defence policy was the responsibility of cabinet. Cabinet was assisted in making defence policy by the council of defence, a statutory body created under the Defence act. The council consisted of the prime minister, the ministers for defence, external affairs, navy, army, air, munitions, postwar reconstruction, the leader of the government in the senate, the chief of the naval staff, the chief of the general staff, the chief of the air staff, and the secretary of the department of defence. The minister for defence was advised by a defence committee consisting of the service chiefs of staff, a representative of the defence department, the controller general of munitions supply, and a defence scientific adviser. The chiefs of staff committee, consisting of the service chiefs, was responsible for preparing strategic appreciations and military plans for the government. The defence committee was assisted by a joint intelligence committee consisting of the directors of naval intelligence, military intelligence, RAAF intelligence, the controller of joint intelligence, and a representative of external affairs.

Evatt’s foreign policy first began to conflict with the United Kingdom government’s foreign policy at the Commonwealth prime ministers’ conference in April–May 1946. The British foreign secretary, Ernest Bevin, bemoaned the difficulty of penetrating the ‘iron curtain let down by the Russians’ in eastern Europe. Defence

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2 Higher defence machinery, CRS A1068 T4 DL 47/7/3, AA.
discussions at the conference showed that the United Kingdom was aiming at a ‘coordinated global system of Commonwealth defence’ against the ‘aggressive’ intentions of the Soviet Union. Chifley, in reply, stressed that Australia’s defence concerns lay in the Pacific, and Evatt added that the British Commonwealth should not assume that war with the Soviet Union was inevitable. Issues, he said, should not be decided on the assumption of ‘military and strategic planning with Russia as the designated enemy’: rather, decisions should be made in ‘accordance with the principles of justice’ which were those of the United Nations. 3 Chifley and Evatt broadly agreed with the principle of a coordinated system of Commonwealth defence, but refused to agree to any decision which involved a defence commitment outside the south Pacific or the specific identification of the Soviet Union as the enemy of the British Commonwealth.4

In his report to parliament on 19 June Chifley said that the 1946 prime ministers’ conference marked a devolution of responsibility and planning for empire defence from a centralized to a regional basis. The Australian government had agreed to make a larger contribution to the defence of the British Commonwealth. By agreement between the United Kingdom, New Zealand, and later the United States, Australia’s contribution to Commonwealth defence would be in the Pacific. Australian defence machinery, in which the United Kingdom and New Zealand would be represented, would be responsible for strategic planning in the Pacific. Chifley hoped also to arrange for Australian representation in the defence machinery of the United Kingdom and the United States. He added that the Australian government was anxious to provide, by developing government factories and fostering commercial industry, a self contained supply structure for the needs of the British Commonwealth in the Pacific. Chifley wanted Australia to become as self sufficient as possible in the manufacture of

3 Minutes of first meeting of the Commonwealth prime ministers’ conference, 23 April 1946, CRS A816 11/301/586, AA.
4 Ibid., minutes of fourth meeting of the Commonwealth prime ministers’ conference, 25 April 1946.
armaments and munitions of war. He did not want Australia to remain dependent for defence supplies on the United Kingdom.5

The Chifley government developed its postwar defence policy on the basis of collective security through the United Nations and also on the basis that Australia would be responsible for the defence of its own region. The minister for defence, John Dedman, announced a five year plan to give effect to these principles on 4 June 1947. The government would spend a total of £250 million in the five years, at an average rate of £50 million per year. The army programme consisted of two elements: permanent forces of one independent brigade group and a fixed establishment of 14,000 men; and a militia enlisted on a voluntary basis comprising two infantry divisions, and an armoured brigade group with a total strength of 50,000 men. The navy received the highest vote – an annual grant of £15 million at a total cost over five years of £75 million. The army and air force both received £62 million over five years. Defence research and development received a huge £33 million over five years. Dedman’s five year defence plan was a long range programme based on the assumption that war would not break out for a long time.6

The opposition parties did not believe that the newly formed United Nations Organisation gave Australia as large a measure of security as the Labor government supposed. The leader of the opposition, R.G. Menzies, pointed out on 7 November 1946 that future wars were likely to involve at least one great power. Since each great power had a veto over any coercive action to settle international disputes, the Security Council could not prevent great wars except by the process of friendly argument which happened to lead to ultimate agreement between all parties concerned. Menzies’ view was that because the United Nations was unlikely to be able to take action against an aggressor nation, Australia had to make a larger contribution to the collective defence

of herself and her major allies. The government’s five year defence plan did not impress the Liberal and Country parties. Typical of opposition criticism was Henry Gullett’s speech on 26 September 1947. Gullett pointed to the dangers of the Soviet Union’s interest in the Pacific, of China becoming a Russian satellite, and of the Dutch being replaced in Indonesia by a hostile indigenous regime. He assailed the Labor government for underestimating the potential for conflict in a rapidly changing world and for the inadequacy of Australia’s militia system. The only acceptable basis for the defence of Australia, he said, was that of universal military training.

In formulating its defence policy, the Chifley government vetoed its military advisers on two important issues – compulsory military training and the liability of the Australian army to serve overseas. The original army post war plan of September 1946 stated that because Australia could not support large permanent forces in peacetime, the citizen military forces had to provide the basis for expansion and mobilization in time of war. The plan recommended a ‘system of national service under which the young men of the country serve for one period of four months’ continuous training’. The defence committee agreed on 19 September 1946 that ‘a scheme of national service on the lines proposed in the army plan is necessary for the army and is very desirable for the navy and air force’. However on 12 March 1947 Chifley told the council of defence that the question of national service was a matter of government policy. Cabinet later decided that the citizen military forces should be raised on a purely voluntary basis but that ‘this plan could be readily adapted for the introduction of national service training if, at a later date, a change occurs in the international situation or in government defence policy, and as a result, it is decided that a higher state of readiness is required.’

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9 ‘Notes on army post war plan’, n.d. CRS A816/1 52/301/305, AA.
The Labor government also disagreed with its military advisers on the issue of whether the Australian army should be liable for overseas service. Under the defence act passed in the early years of the Commonwealth of Australia, members of the Australian army were not required to serve, unless they voluntarily agreed to do so, beyond the limits of the Commonwealth. The forces raised to serve overseas in the first and second world wars were not the Australian army but volunteer expeditionary forces to whom the defence act did not apply. Members of the navy and air force were liable, under the defence act, to serve wherever they were required. The post war plan proposed that all members of the Australian army should be liable to serve overseas in time of war. The defence committee endorsed this policy but on 3 June 1947 cabinet decided to defer making a decision about the defence committee’s recommendation. When discussion of the matter was resumed in September, the vice chief of the general staff advised the government that the liability to serve overseas was a ‘fundamental’ requirement of Australia’s defence. He added that because it was unlikely that there would be much advance warning in future wars, the armed forces existing in peace time should be mobilized and available to move as early as possible to battle stations in accordance with pre-arranged plans. The difficulty was that no firm defence plans could be made unless the government removed the uncertainty as to whether the army was available for overseas service.

The defence committee considered that the requirement of overseas service, on a purely voluntary basis, was a logical corollary of the Australian government’s policy of contributing to collective and Commonwealth security arrangements. If the army did not know whether the forces it raised would be available for overseas service, no joint service plans could be made which involved the army as a component of any task force that may have been required. The committee therefore recommended that the

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permanent military forces should consist of men who had voluntarily agreed to serve overseas in time of peace and war and that the citizen military forces should consist only of men who had voluntarily enlisted to serve overseas in time of war. This proposal would only apply to men who had voluntarily enlisted in time of peace, and not to forces raised by conscription after the outbreak of war. It was consistent with the defence act. Nevertheless the Chifley government refused to implement the defence committee’s plan. No member of the Australian army would be obliged to serve overseas unless he had volunteered.

In February 1946 Chifley asked the departments of defence and external affairs to prepare a strategic appreciation as a basis for planning a regional defence arrangement for the Pacific. The chiefs of staff, however, disagreed with this approach arguing that a threat to the security of Australia was more likely to arise somewhere else than in the Pacific and that ‘strategical isolation is irreconcilable with the realities of modern war’. They recommended planning on a global basis. The chiefs of staff – Admiral Sir Louis Hamilton, Lieutenant General S.F. Rowell, and Air Commodore F.R.W. Scherger – produced a strategic appreciation of Australia in September 1947. This appreciation contradicted the Chifley government’s foreign policy. The chiefs argued that the United Nations could not guarantee Australia’s security. While the power of the veto remained with all the permanent members of the Security Council, the United Nations would break down if any one of the great powers contemplated aggression. The new world organisation would need a testing period to sort out its problems and therefore ‘no great reliance can be placed on the United Nations until it is proved to be an effective organisation.’

In looking at potential enemies the chiefs of staff were quick to discount the danger of an attack by a minor power, because an attack on any individual British

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12 ‘Defence policy and national security: a directive for the guidance of the defence department and of the department of external affairs on related aspects’, by J.B. Chifley, 15 February 1946, CRS A816 14/301/371; Chiefs of Staff committee minute 12/1946 AA.
Commonwealth country would involve the aggressor in war with the other members of the British Commonwealth. Of the major powers Germany had been eliminated as a threat and Japan had been rendered militarily impotent as a result of the Pacific war. But they warned that unless Japan was subjected to effective control, it might again become an aggressor, or ally itself with some potential enemy of the British Commonwealth. They discounted China as a threat to Australia’s security because of political and economic difficulties in that country. This left the Soviet Union.

The chiefs of staff pointed out that the Soviet Union was a first class power with large manpower and economic resources. They thought that a threat to Australia might follow from any possible hostile act in the Middle East, the Far East, or Europe itself. Incidents in any of these areas, but particularly in the Middle East, might threaten vital British Commonwealth interests and result in war. And such a situation ‘could result in Australia becoming involved, because of ties with the United Kingdom or because it was felt that Australian participation was essential in order to protect her ultimate position’. They considered that the Soviet Union had vital interests to protect in the Far East and that it was unlikely to regard its position as being consolidated there while United States influence was predominant in Japan. Withdrawal of the United States from Japan would probably have the effect of inviting Russian suzerainty over Japan. There was also a danger to South East Asia, and therefore to Australia, if the Soviet Union should dominate or become allied with China. The chiefs viewed South East Asia as an important object of Soviet strategy because of that region’s importance to the economies and strategic dispositions of the western powers. Unrest in South East Asia would have a profound effect on the western powers’ military capacity in Europe. Finally the chiefs looked at the Soviet threat to the Middle East. Since the region was believed to contain one third of the world’s oil supplies, and since the Soviet Union’s own supplies were exhaustible, they considered that the Soviet Union must at some stage look beyond its borders to increase them. And since about seventy five per cent of
the British Commonwealth’s oil supplies came from the Middle East, they averred that the Soviet Union might see a strategic advantage in denying these supplies to the West.

The chiefs went on to analyse the time factor in a possible war. They declared that: ‘while there is no evidence to show that war between the British Commonwealth of nations and the USSR is inevitable, the possibility cannot be overlooked that such a conflict will occur.’ They thought that the state of the Soviet economy was such that it was unlikely to be in a position to precipitate a war before at least 1951. Only by 1960 would its economic development be sufficiently advanced to support an aggressive foreign policy, backed by military forces, including scientific weapons. But should the international situation deteriorate before 1951, they cautioned, ‘economic unpreparedness might not deter the Soviet Union from resorting to war as an instrument of foreign policy’. War against the USSR would not be confined to any one area, but whatever course it might take, the Australian Chiefs thought that there would always be a threat to British Commonwealth interests from Soviet aggression in Europe, the Middle East, India, and South East Asia. Moreover if Russia developed sea power, there might even be a direct threat to the Pacific.

In the light of this analysis, the chiefs of staff recommended that before the United Nations became an effective institution – and their implication was that it never would – Australia should rely for its security on a system of British Commonwealth cooperation and ‘upon such arrangements as are practicable with foreign nations, particularly with the United States of America’. They supported the British government’s position that the Commonwealth of nations should formulate an overall strategic plan in peacetime. Consequently Australia’s armed forces ‘should be organised at home or abroad as required’. Should hostilities occur before these plans had been formulated, ‘each nation of the British Commonwealth would be primarily concerned with the defence of its own zone of strategic responsibility and its vital communications’. In Australia’s case its zone of strategic responsibility – the ANZAM area – would be demarcated by a line drawn 1500 miles to the east of Australia’s
coastline and would extend to the island chain to the north of Australia including Singapore, North Borneo, and Manus. That island chain was particularly important because if it were subdued by a hostile power, the enemy would then be in a position to make an invasion on the north west coast of Australia.  

Defence’s strategic appreciation contained much in it that was contrary to the approach to defence and foreign policy favoured by Evatt and the mercurial secretary of the external affairs department, J.W. Burton. A graduate of the London School of Economics, Burton was appointed secretary of the department of external affairs in 1947 at the age of thirty two. He was a zealous Australian nationalist and a strong supporter of Evatt’s internationalist liberalism and consequently was drawn into opposition to the more traditional imperialist views of the secretary of the department of defence, F.G. Shedden. Burton was concerned that all the planning of the defence department was based on the assumption that Australia would undertake military commitments in Europe or the Middle East, under the direction of the British, against the Soviet Union. Burton wanted the government to put a stop to this line of thinking by issuing a directive that Australia would not accept any military commitments beyond the ‘near South East Asian area’ and under no foreseeable circumstances in the Middle East. Alternatively Burton thought that the government could simply decide that in the event of conflicts outside the Pacific and South East Asia, Australian manpower would be not be sent to fight overseas but would be used at home for the production of food and other essential materials for the allied war effort. If the government would issue a directive to defence on these lines, there would be no necessity for strategic planning further afield than in Australia’s own strategic zone.  

The council of defence considered the views of the chiefs of staff on 20 April 1948. It confirmed Evatt’s policy completely. It argued that the starting point of a strategic appreciation on which a defence policy could be based, ‘is the assessment of

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13 ‘The strategical position of Australia’, September 1947, CRS A816/1 14/301/321, AA.
14 Burton to Evatt, 15 April 1948, CRS A1068 T 47/5/1A, AA.
the risks of the international situation, and this, in the last analysis, is a matter of the government's foreign policy.' The government's foreign policy, the council pointed out, was based on unwavering support of the United Nations. While the council regarded cooperation between members of the British Commonwealth and other allies in regional defence as consistent with the purposes and principles of the United Nations charter, it did not think that the designation of a particular enemy – the Soviet Union – was consistent with those principles and therefore with Australia's foreign policy. As for the idea of an overall Commonwealth strategic plan, the council thought it impracticable on the grounds that political agreement by all members of the Commonwealth with each other would be impossible. The council dismissed the idea of designating the Soviet Union an enemy and planning for war against it, and dismissed the idea of Australia conforming to an overall British strategic plan in which Australian forces would be obliged to serve outside the Pacific area. 15

The council suggested that strategic planning should be developed within the zone suggested by the chiefs of staff in order to deter a potential enemy from establishing bases within range of Australia. However it doubted whether Australia had the resources to accept the responsibilities which the chiefs of staff said would be involved in the defence of the ANZAM area. It pointed out that the United Kingdom 'would not if engaged elsewhere, be able to make any large contribution to the remainder of the Pacific in which forces are not maintained by them in peace.' There was in fact no commitment to the defence of Australia's strategic zone of responsibility by either the United States or the United Kingdom. Despite this uncertainty, the council gave defence permission to plan for the defence of Australia's local zone, with the proviso that this did not imply 'any commitment to the despatch of forces outside Australia without approval by the government, and conformity to legislative provisions for service abroad.' 16

15 'Conclusions of the council of defence', agendum 1/1948, 20 April 1948, CRS A816 14/301/32, AA.
16 Ibid.
By the end of 1947 the final meeting of the council of foreign ministers – a council consisting of the allied western powers of the second world war and the Soviet Union – led to a total breakdown between the western powers and the Soviet Union. The British foreign secretary, Ernest Bevin, responded positively to the American idea that western Europe should integrate politically and economically in return for dollar aid from the United States. He adopted the view that the United Kingdom should take the initiative in forming a western democratic system – a defensive alliance against the Soviet Union – comprising most of the western European countries. The first step in this process was a joint offer from the British and French governments to form an alliance with Belgium, the Netherlands, and Luxemburg. A message from Attlee to Chifley on 14 January 1948 gave the Australian government the background to the policy of Western Union. Attlee told Chifley that the British were contemplating a defensive alliance comprising Britain, France, Scandinavia, the Low Countries, Portugal, Italy, and Greece, and extending, when circumstances permitted, to include the former fascist nations Spain and Germany. This alliance would be backed by the economic resources of the European signatories, which would be consolidated by Marshall aid. Attlee sought the concurrence of the dominions in the United Kingdom’s policy.

On 22 January 1948 Chifley sent a reply to Attlee which bore all the hallmarks of having been drafted by Evatt and Burton. He remonstrated at the British failure to inform him of its policy towards Greece and the Middle East. The British government was maintaining a sternly belligerent posture towards left wing insurgence and external Russian involvement against the monarchist and right wing Greek government. And in the Middle East Britain and the Soviet Union confronted each other over Iran, when Russian backed insurgents staged a revolt against the Shah of

18 ‘Nato formation UK-Australian attitudes’, Message from Attlee to Chifley, 14 January 1948, CRS A1838 TS 78/7 AA.
19 Morgan, op. cit., pp.251-5.
Iran in Azerbaijan and the British backed the Iranian government. Both of these regions were exacerbating Anglo-Soviet tension. Chifley declared:

"Generally speaking, the Australian people...are not convinced of the desirability of giving support to any decision to form a western alliance directed against the Soviet [Union], particularly when that alliance is to include such undemocratic governments as exist at present in Spain and Greece."

He disagreed with Attlee’s argument that the Soviet threat demanded the organisation of the ‘ethical and spiritual forces of western Europe backed by the power and resources of the Commonwealth and of the Americas’. European morale was not being sapped by the threat of Soviet invasion but rather by the failure of European governments to provide for economic stability and for the necessities of life of the people of Europe. The British might well be ‘left to carry out a United States policy which the United States is not prepared, for constitutional reasons, to carry through’.

Broadening the range of his attack, Chifley affirmed that support of ‘undemocratic’ governments like Greece’s simply because they were anti-communist, was unconscionable. In such cases he and his foreign minister preferred ‘not to allow decisions on strategy to influence our considerations of disputes which can only be settled permanently on the basis of justice.’

Chifley lamented the break up of the council of foreign ministers in December 1947, a break up which began the train of events leading to the Berlin dispute. But he hinted that the United States was partly responsible for this. And while noting that Russia was suspicious of the western powers he argued that ‘it is no solution to confirm this suspicion by making an offensive alliance against Russia.’ He could not therefore offer the Australian government’s support for the policy of Western Union. Rather the Australian government would continue to uphold the principles of the United Nations: press for reform and new elections in Greece; insist on the implementation of United Nations policy on Palestine; refuse to support the ‘corrupt’ Nationalist government of

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20 Ibid., pp.250-1.
21 Chifley to Attlee, 22 January 1948, CRS A1838 TS 78/7, AA.
China; refrain from forming 'secret alliances'; and refrain from using economic power to determine the nature of governments. But when 'justice' demanded, it would agree that the strongest action should be taken through the United Nations against the Soviet Union or any other power in order to uphold the United Nations charter.' Chifley also warned Attlee that, in the event of a European conflict, Australian manpower might have to be diverted for the protection of the Pacific area. Australia, he finally asserted, would be well placed in the future to act as a mediator in the broader dispute between the Soviet Union and the western powers, in which case its position would be compromised by support, clandestine or open, for an anti–Soviet alliance. 22

Chifley's message reached London shortly before Bevin made his famous speech in the house of commons, outlining the measures which the United Kingdom would take to resist the spread of communism in Europe. The British government's anger at Chifley's attitude was clear enough when in early February Attlee replied. The United Kingdom government, he said, was not planning to form an offensive alliance against the Soviet Union but rather a 'moral and material force' in western Europe which would provide a counter–attraction to the 'baleful tenets of communism'. The message also criticized Chifley for urging all the major powers to cease trading in the munitions of war. The British counter–argument was that since the Soviet Union would undoubtedly not cease to trade in arms, it would be folly for the western powers to deny arms to people resisting communist aggression. If the 'present fatal drift' towards economic collapse in western Europe and to war was to be arrested and the tide turned in western Europe's favour, it needed the wholehearted backing of the Americas and the Commonwealth. Attlee noted Australia's compelling interest in the Pacific but simply said 'when all is said and done, the key to the situation is in Europe'. 23

22 Ibid.
23 Attlee to Chifley, n.d. February 1948, CRS A1838 TS 78/7, AA.
Chifley replied to this message on 11 February. Although he acknowledged that a drift to war was perceptible, he could not agree with Britain forming an anti-Soviet alliance. Moreover while appreciating Britain’s need for the military and economic support of the United States, he thought that this support should not be obtained on the understanding that war with the Soviet Union was inevitable. The view that war was inevitable appeared to him ‘on private advice we have received, as being fostered by certain sections in the United States of America.’ Chifley no doubt registered here the concerns of Evatt and external affairs. But he was himself more concerned that a western European customs union should be formed:

I cannot emphasise too much or too often the seriousness of taking decisions clearly involving us, or in expectation of our support, without the fullest prior consultation. One instance where we are completely uninformed is the matter of a customs union. We are being asked and will no doubt be questioned in parliament, as to our knowledge of this matter. We can only say that we have no knowledge as to how the union is to work.24

In reality Bevin’s call for western economic union was an attempt to counter American and continental pressure for European integration, by sponsoring a looser form of union which would enable the United Kingdom to reconcile its leadership of the sterling area with the imperative of European cooperation.25 But the Australians did not know this.

On 16 April Attlee and Bevin directed the British high commissioner to try to come to some sort of understanding with Evatt about Western Union. In their instructions to the high commissioner they dismissed Evatt’s notion that American financial interests were behind talk of a future war. They argued that Europe was in grave danger of communist infiltration and that, rightly or wrongly, European governments ‘felt directly threatened by the presence of large Russian armies which can at any moment overrun them’. There was also a fear of communist insurrection

24 Telegram 88 from UK high commissioner to Commonwealth relations office, 11 February 1948, PRO PREM 7/87 supplied to author by C.D. Waters.
from within these countries. Evatt had floated the idea of creating a ‘third force’ in international politics: a bloc consisting of Britain, the dominions, and some of the western European countries, midway between the United States and the Soviet bloc. This idea was the political analogy of Cripps’ notion of a second trading world separate from the United States. Attlee and Bevin dismissed the idea as impractical without American backing. Further they argued that if many western European countries did not get dollar aid under the Marshall Plan, they would not be persuaded to depart from a position of ‘timorous neutrality’; and in Britain’s case, without dollar aid, it could not secure its essential interests in the Middle East. They declared that their policy was to negotiate with the Soviet Union from a position of strength and to negotiate with the United States without compromising British independence. 26

The United Kingdom high commissioner saw Chifley and Evatt on 28 April, relaying to them the contents of the instructional telegram of 24 April. He also discussed the possibility of United States backing for an American, Canadian, and western European defensive alliance based on article 51 of the United Nations charter – the future North Atlantic Treaty Organisation (NATO). 27

On hearing of the conversation between the United Kingdom high commissioner and Evatt and Chifley, Burton dashed off a furious memorandum describing the whole situation as ‘preposterous’. He thought that it was hypocrisy to base the proposed North Atlantic Treaty Organisation on article 51 of the United Nations charter, arguing that article 51 merely gave UN members the right ‘to individual or collective self defence if an armed attack occurs against a member of the United Nations until the Security Council has taken the measures necessary to maintain international peace and security’. He did not think that article 51 authorized states to concert together against a potential attack by a specified hypothetical enemy. He also criticized the idea that the United

26 Cablegram 258, secretary of state for Commonwealth relations to the United Kingdom high commissioner in Australia, 24 April 1948, CRS A1838 TS 78/7 AA.
27 Ibid., record of conversation sent to John Burton, 3 May 1948.
The whole idea apparently is that Russia will be restrained if the United States give the public warning. The assumption is made that Russia has an aggressive intent. In fact the probability is that the so called ‘warning’ will be interpreted as another move to encircle Russia and will bring about just the set of circumstances that the proposal purports to avoid. In other words, this will be the signal to go ahead in including other countries in the Russian security zone.

Burton argued that the British and American proposals communicated to Chifley constituted one of the most blatant statements of the policy of containment that I have seen. In fact, it is not containment but encirclement. If this is US and UK thought, any responsible Soviet government must, in the interests of its own security, immediately take all possible steps to prevent the military encirclement which is being backed by economic encirclement.

He told Evatt that the question was what action could be taken ‘to prevent the implementation of a fatal policy such as this is’. Burton was furious that Australia’s representatives overseas were not managing to combat the argument that the only danger to world peace was in Europe, and that Australia’s fears regarding United States policy in Japan were groundless. He suggested that Chifley should either sack Australia’s representatives in London and Washington, or ‘alternatively agree to the appointment at both places of officers who can see implications of US and UK policy on Australia and whose instructions would include the right to be associated with all the political activities of the Australian representatives at both places’.

The British government responded to the kind of criticisms voiced by Burton in a letter of 14 August to the New Zealand prime minister, but repeated to the Australian department of external affairs. The British argued that the signatories to the United Nations charter had envisaged a strong system of collective security under articles 43

28 Ibid., memorandum from Burton to Evatt, 3 May 1948.
and 45 of the charter; a system of economic sanctions under article 41; the abolition of all weapons of mass destruction including the atom bomb; and a rigid and all embracing control to ensure that these obligations were carried out. The signatories to the UN charter had contemplated regional arrangements under article 52, but such regional arrangements would be subject to the overriding authority of the Security Council, and hence of the Soviet veto. They felt, therefore, that it was essential to build up ad hoc groups of 'peace loving states' under article 51 of the charter, an article not subject to the Soviet veto. Their government preferred a policy of supporting regional defence pacts to one of amending the United Nations charter to get rid of the veto in the Security Council. Evatt's view, in contrast, was that a political situation had to be created in which the great powers would willingly allow themselves to be overridden on questions of vital importance by some majority of states in the Security Council or General Assembly, and agree to abide by the decision so reached. The British concluded that a policy of forming regional defence pacts was the only one which would prevent 'reckless aggression during the period before the Russians have been brought to a wiser state of mind.'

In 1948 the international tension between the Soviet Union and the west worsened and began to test the assumptions of the Chifley government that world peace would be assured by the United Nations. The opening of the Marshall aid programme was followed by the first battle of the Cold War, and the decisive one for Europe, over the fate of Berlin. Though the Russians did not seem to have anticipated this outcome, it established the point at which Europe, Britain and the United States were prepared to fight. The United States was determined to reanimate the economy of at least western Germany, and to incorporate it into an integrated western Europe, before the future political shape of Germany as a whole had been determined. The Russians, on the other

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29 *Ibid.*, the secretary of state for Commonwealth relations to Peter Fraser, 14 August 1948, CRS A1838 TS 78/7 AA.
hand, were concerned to prevent the re-emergence of a united and economically powerful Germany which was not under their influence.

The capital of Germany, Berlin, was occupied jointly by France, Britain, the United States and the Soviet Union, although it was located in that sector of Germany occupied exclusively by the Soviet Union. When the allied discussions on the future of Germany broke down at the end of 1947, and the western allies began plans for the establishment of a west German government, the Soviet Union imposed restrictions on communications between Berlin and the western occupation zones. And when the Russians and the western powers introduced separate currencies in their respective zones of Berlin in June 1948, the Russians cut rail, road, and canal communications between the western occupied zones of Germany and Berlin. Responding to this blockade, the western powers set about supplying West Berlin from the air. The Berlin blockade had the potential of triggering a full scale war between east and west.

The blockade dragged on for months. On 29 September 1948 the three western powers brought the issue of the Berlin dispute before the Security Council of the United Nations. The substance of their charge was that the Soviet Union was attempting 'by illegal and coercive measures... to secure political objectives to which it is not entitled and which it could not achieve by peaceful means... to obtain absolute authority over the economic, political, and social life of the people of Berlin, and to incorporate it into the Soviet zone.'30 Some of the smaller powers on the Security Council put up a conciliatory resolution calling for the lifting of the Russian blockade of Berlin, and an immediate meeting of a four power conference to arrange for the unification of the currency on the basis of the German mark of the Soviet zone, under the control of a quadripartite financial commission. The Soviet Union vetoed this resolution on the ground that it did not provide for the simultaneous introduction of a new currency

30 Text of the notification by the government of the United States to the Security Council of the United Nations, 29 September 1948, CRS A1838/2 29/2/2/4/5, AA.
with the lifting of restrictions on communications. The Security Council was thus rendered impotent to settle the dispute.

It was at this point that the General Assembly of the United Nations intervened. In the debates on the charter of the United Nations, Evatt had fought against the right of veto in the Security Council. Despite having lost that battle, Evatt maintained that the United Nations was still capable of settling disputes in which one great power used its right of veto in the Security Council. This was because, if a dispute became bogged down in the Security Council, it could be referred to the General Assembly. The Mexican delegation brought the whole question of great power cooperation before the General Assembly in November. The General Assembly called upon the great powers to 'redouble their efforts...to achieve in the briefest possible time the final settlement of the war and the conclusion of the peace treaties'. Evatt, now president of the General Assembly, and his colleague the secretary general of the United Nations, decided to take action on the General Assembly's resolution. They appealed to all the great powers, on 18 November 1948, urging the desirability of immediate talks, and of taking all the steps necessary to resolve the Berlin dispute, thus opening the way for a prompt resumption of negotiations for the remaining peace settlements. 31 At the same time as Chifley was expressing public support for the western powers' relief of west Berlin, Evatt was maintaining that the impasse should not be allowed to remain unresolved indefinitely. 32 The Americans and the British were furious with this intervention, arguing that the first step in the resumption of negotiations between the great powers had to be the lifting of the Russian blockade of Berlin.

The opposition in the Australian parliament also attacked Evatt's actions. Eric Harrison, the acting leader of the opposition in the absence of Menzies, pointed out that the Berlin dispute was still before the Security Council when Evatt intervened on

31 Ibid., cablegram 212 text of Evatt's and Lie's letter from Australian delegation to UN to external affairs, 18 November 1948.
behalf of the General Assembly. He also declared that: ‘the western powers had already refused four power talks while the Russian blockade continued, and by cutting the ground from under their feet, Dr Evatt has placed the western powers in the light of being war mongers should they reiterate their former decision.’ Harrison saw Evatt’s action as ‘part of a series of acts of interference which can only cause concern to the allied powers in their efforts to preserve democracy against the pressure of Soviet influence.’

The tension between east and west had provoked a strong anti-Soviet foreign policy from the British. Bevin outlined the reasons for this policy to the London Commonwealth prime ministers’ conference in October 1948. There was the western allies’ support for democratic elections in liberated countries and the Soviet Union’s resistance of them. In Germany this arose in acute form. On the one hand, the western allies had sought to build up a united Germany based on a federal system with considerable powers left to the states. On the other hand, the Soviet Union had aimed at a highly centralized state. The western powers had sought to revivify western Germany’s economy whereas the Soviet Union had stripped eastern Germany of its capital assets and demanded reparations from current production. Another factor was the issue of currency reform which had led to the Berlin dispute. Elsewhere, the civil war in Greece was creating problems for British foreign policy. Bevin saw Greece as a strategic rather than a political problem. The real issue in his mind was whether the Soviet Union would secure control of the Dardanelles, and whether Greece and Turkey would become Soviet satellites. The civil war in Greece represented ‘merely a move towards the Soviet objective’. Because of what Bevin perceived as both direct and indirect Soviet aggression, the United Kingdom and its allies had to take steps to thwart

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32 In addition to this action on behalf of the General Assembly, Evatt expressed his reservations on America’s Berlin policy to the United States secretary of defence, James V. Forrestal. (Glen St John Barclay, Friends in High Places, Melbourne, 1985, p.28.)
33 CPD. Vol. 200, 9 December 1948, p.4357.
34 Ibid., p.4358.
the Soviet Union. The formation of a Western Union, based on the premise that the United Kingdom was not in a position to build effective defences by its own efforts, was a practical step in this direction. Bevin noted Britain’s dependence on trade with the Commonwealth. But he saw Western Union as ultimately beneficial to the Commonwealth, because when the European economy was restored, it would be able to supply the sterling area with greater supplies of capital goods.35

Evatt, who was representing Chifley at the conference, proved surprisingly supportive of the British case. He talked of the necessity, in some cases, of abandoning ‘just’ conclusions, arrived at after considerations of individual problems in isolation, because of the ‘over-riding claims of expediency’. For example he castigated constant interference from the Soviet Union in the affairs of Greece. Consequently, a ‘just’ conclusion, while concentrating on improving internal conditions in Greece, would require firm support against external interference. Referring to another problem area, he argued that the whole of the Middle East was of strategic importance, and therefore that claims of expediency there had to be balanced against claims of justice. At the heart of all the international problems pointed to by Bevin, Evatt saw the Soviet Union. Thus, for example, if the Austrian and Japanese problems were looked at in isolation, there was no reason why ‘just’ peace treaties could not be concluded. However this was not possible because of the strained relations between the Soviet Union and the United States. Evatt saw three reasons for this tension: the ineffectiveness of the Security Council owing to the Soviet Union’s veto power; the principle of four power unanimity in resolving problems being pushed to excessive lengths; and the lack of progress towards peace settlements. In Evatt’s mind, the Cold War resulted not from innate and irreconcilable differences between the great powers, but from reformable defects in the international mechanisms for solving disputes. Evatt now acquiesced in defensive alliances under article 51 of the United Nations charter, in Western Union,

35 Minutes of the London Commonwealth prime ministers’ conference, third meeting 11 October 1948, CRS A5954/1 Box 1790 AA.
and in the western stance on the relief of Berlin, though he thought that talks had to resume before the Russians lifted the blockade. 36

Evatt's statements at the prime ministers' conference suggest a modification of his foreign policy. Indeed Burton alleged that from about that time, Evatt began to base his foreign policy on 'expediency' rather than 'principle'. 37 It is possible that Chifley may have had something to do with smoothing over differences between the United Kingdom and Australia, after his visit to London to discuss the dollar problem in July 1948. Whilst there is no doubt that Evatt was persuaded to back away from his hard line opposition to British foreign policy, the evidence suggests that there was no major change in the principles of Labor's foreign policy: to support internationalism and the United Nations; to continue to base Australian defence policy on the protection of the south west Pacific area; and to resist making commitments to western defence systems based on the assumption of war with the Soviet Union. Evatt's foreign policy, still based on 'principle', merely made concessions to 'expediency'.

This can be illustrated by looking more closely at Evatt's remarks on defence problems in London in October 1948. Attlee declared that the Soviet Union had rendered a comprehensive system of security through the United Nations ineffective. So the United Kingdom had now to look at regional arrangements covering western Europe and the Atlantic. Lord Tedder, on behalf of the United Kingdom chiefs of staff, reinforced these remarks by referring to a 'cold war' directed by Moscow, with the object of sapping the power of democratic countries and creating the conditions of chaos in which communism flourished. Tedder discussed the broad outlines of strategy in a possible war. He said that British strategy was to defend the United Kingdom, the sea communications between the United Kingdom, the United States, and the rest of the Commonwealth, and the Middle East. He wanted an ultimate commitment by the

36 Ibid.
Commonwealth to the defence of the Middle East, though he was satisfied, for the time being, with joint Commonwealth strategic planning in that region.38

Evatt replied that the Australian government was in general agreement with the British position. But he only accepted the view that military planning should be based on the assumption that the enemy would be Soviet Russia. He did not think that the Soviet Union would provoke war. Its aim was rather to use methods such as political pressure and infiltration which fell short of active war or aggression. If war were to break out, it would develop from a minor incident, and it would be a global and not a regional war. So there was a need for British Commonwealth military planning. Here Evatt was supporting the need for an overall British Commonwealth plan, which might involve the strategy of defending the Middle East, but he gave no indication that Australia would do anything else but plan for the defence of the south west Pacific. And later in his remarks, he reverted to his internationalist stance, arguing that ‘political actions based on considerations of justice might have to outweigh immediate political advantage’. He did not hold out much hope for a comprehensive agreement with the Soviet Union, but he thought that agreement could be reached step by step. And finally he asserted that the fundamental basis for British Commonwealth foreign policy should still be support for the United Nations.39

The Australian defence representative to the London conference, Major-General A.J. Boase, argued strongly to Evatt that the final issue of the next war would be decided in Europe. He thought that it could be assumed that the United States would be in the war from the beginning, and that any commitment arising in the Pacific would be covered by her. He was confident that while the United States maintained its naval and air supremacy in the Pacific, no direct threat to Australia could develop. The Middle East was strategically important because from it Australia’s sea

38 Minutes of the Commonwealth prime ministers’ conference, confidential annex, October 1948, CRS A5954/1 Box 1790, AA.
39 Ibid.
communications through the Mediterranean and Indian Ocean could be attacked. The region had valuable oil resources and had bases from which an air offensive could be launched by the allies against important Russian industrial areas and communications which would otherwise be out of range. Boase concluded that the Middle East was extremely important to the allied war effort as a whole and of particular interest to Australia. He therefore found it a serious omission that although the Australian chiefs of staff recommended an Australian contribution to the allied defence of the Middle East or Far East, the council of defence made no such recommendation.

Retention of the Middle East area, therefore, may be more urgent and vitally important to the security of Australia – at least in the early stages of a war, than South East Asia: consequently, an Australian contribution to the former area may best help to safeguard the Australian continent.40

The Australian defence committee reviewed the defence discussions of the London prime ministers’ conference on 11 November 1948. The committee summarized the British arguments about the existing international situation. These were that the establishment of collective security through the United Nations had broken down. Soviet policy and aims were a threat to all free nations, who were in danger of being subjugated one by one. Soviet policy, if pursued, would inevitably lead to a clash. And Soviet forces could engage in a land war at any time. The probability of the Soviet Union engaging in a major war before 1956 might be conditioned by economic factors, and, for a time, by its relative air power. If it wished to go to war and felt confident of attaining its primary objectives rapidly, economic considerations would not in themselves prevent it from doing so. The defence committee argued that the ultimate security of Australia in war depended upon cooperation with other members of the British Commonwealth and the United States:

Accordingly, decisions as to the relative strengths of the three Australian services, their composition, the nature and proportion of their armaments, and the material resources which Australia should be able to produce in war should be based on the overall general defence policy and strategy which is likely to be adopted in war, and Australia’s part in it.

40 'Australian joint services liaison staff – British Commonwealth defence cooperation', by A.J. Boase, n.d., CRS A5954 Box 1790, AA.
The committee concluded that in conjunction with the United Kingdom and New Zealand joint service liaison staffs, it should commence an examination of the basic objectives of British Commonwealth defence policy and general strategy, and a suitable basis for the distribution of strategic responsibility and the Australian war effort.41

Chifley made it clear, however, that the discussions between British and Australian defence staffs should not be regarded as committing the government, unless specific authority for a plan had been sought and obtained. And more particularly, he declared that before his government would consider, let alone approve, the plans which the defence committee had been authorized to work on, it was essential to have something more than a mere assurance from the United Kingdom Chiefs of Staff that ‘the threat in the Pacific can be adequately matched by American naval and air strength’.42

Evatt’s department was also continuing its strong resistance to the view that Australia should abandon its internationalist foreign policy and regional defence policy in favour of participating in a global anti-Soviet alliance and more particularly to the view that Australia should make a military commitment to the Middle East. As we have seen, the strategic appreciation of the Australian chiefs of staff was a veiled criticism of the Chifley government’s foreign policy. Essentially the paper had argued that the Soviet Union was the only power with which the British Commonwealth was likely to be at war, and that the Australian war effort should most usefully be deployed by the United Kingdom against a Soviet attack in either the Far East or the Middle East. A department of external affairs political appreciation strongly opposed this line.

41 Defence committee minute 252/1948, Report by defence committee on United Kingdom paper P.M.M. (48)1 ‘The World Situation in its Defence Aspects’, 11 November 1948, CRS A5954/1 Box 1790 AA.
42 Attlee to Chifley, 29 December 1948 and attached memorandum ‘Comments by the British Chiefs of Staff on the major military aspects of Mr Chifley’s letter’, CRS A5954 Box 1627 AA.
The political appreciation dealt with the position of Australia, as a South East Asian country, in the event of a conflict between one or more of the western powers and one or more of the eastern European countries. External affairs argued that one of the most crucial factors for Australia in the event of such a conflict would be the attitude of China. Whichever government prevailed in China as a whole, Chinese long standing ambitions in South East Asia, which were temporarily thwarted by similar Japanese ambitions, would be pursued. In the event of a European war in which China played some part, the involvement of South East Asia was certain, regardless of the character of the Chinese government, and regardless also on which side China aligned itself. Australia, whether directly involved in the main conflict or not, would be no less concerned than during Japanese aggression in South East Asia and the Pacific.

External affairs disputed the argument in defence’s strategic appreciation that China offered no threat to Australia because it was impoverished by many years of war. China always was and always would be impoverished because of the poverty of its natural resources. Its poverty supplied a pressing reason for interest in the vastly rich areas of South East Asia. External affairs pointed out that in Malaya there was a majority of Chinese and in almost all other countries in South East Asia there was a Chinese minority which was extremely influential. The department argued that whichever government prevailed in China would endeavour to gain control of the resources of South East Asia through these overseas Chinese populations:

Any open conflict between north and south China, or any involvement in a broader global conflict, will lead to increased interest in South East Asia. A communist dominated China, which could result from the present confused political situation in China, and which could follow quickly on the commencement of an east–west conflict, would certainly aim at acquiring the use of the resources of South East Asia, not by military action, as was the case with Japan, but by internal action, using Chinese populations and the already organised political groupings of secret societies. Presumably, too, assistance in arms and munitions, at present lacking, would reach the peoples of South East Asia.

External affairs concluded that the Soviet Union was not the only major power with which the British Commonwealth was likely to be at war because this implied no
direct threat from the Chinese or from the overseas Chinese in South East Asia. Furthermore the department felt that defence’s opinion that the only likely areas of Australian participation would be the Far East or Middle East, ignored the facts of South East Asia. It considered, however, that national developments in India and other South East Asian countries would counterbalance the military threat from China to the security of South East Asia and Australia. A combination of communist influence, working through Chinese nationals in South East Asia and taking advantage of Chinese policy, could threaten the security of the whole area. But the methods used in the initial stages would not be such as could be combatted by ordinary military manoeuvres.

External affairs proposed a long term policy designed to forestall Chinese or communist domination of South East Asia – which it saw as the a more significant threat to Australia’s security than Soviet aggression in Europe. The programme included a deliberate financial and industrial policy to meet the developmental needs of South East Asia; a policy of making available technical, educational, and administrative assistance to the region; consultation with the United States to enliven interest in South East Asia; and the extension of Australian consular posts in South East Asia. 43

The prime minister forwarded the political appreciation to his defence minister in October. The department of defence was extremely hostile to a political appreciation which challenged its own orthodoxies. Defence did not want to consider any other scenario but that of a global war against the Soviet Union in alliance with the British Commonwealth. The strategy must be to ‘beat Russia first’ in the critical theatres of Europe and the Middle East. It did not think that the Soviet Union could advance far into South East Asia while threatened by the naval and air strength of the United States in the Pacific. And China, in defence’s view, was a ‘negligible’ threat to South East Asia. 44

43 ‘Political Appreciation’, 30 September 1948, CRS A1068/T4 DL 47/5/1 AA.
44 Joint intelligence committee report 72/1949 2 February 1949, CRS A1068 T4 DL 47/5/6 AA.
The Chifley government’s concern that there was too much concentration on problems in Europe and not enough on the problems of South East Asia, did not mean that it was anxious to commit Australian troops to Asia in order to fight communism there. In June 1948, the British colonial authorities declared a state of emergency in Malaya, and the United Kingdom government approached the Australian government for assistance. The preservation of order and stability in Malaya was essential to the United Kingdom, because Malaya was the sterling area’s largest dollar earner. As Peter Edwards has shown, the British and Australian governments viewed the Malayan problem differently. The British attempted to portray the Malayan emergency as a communist revolt directed from Moscow. The Chifley government, in contrast, emphasised the link between communism and nationalism in South East Asia, and argued that the spread of communism there was due to a mixture of European colonialism, the denial of legitimate national claims, and poor economic conditions. Consequently it placed more emphasis on non-military methods of dealing with communism in Asia. To scotch a possible British request for military assistance, Chifley declared bluntly on 17 July 1948: ‘there is no question of Australia sending any troops to Malaya’. The government did, however, under press and opposition criticism, agree to supply small arms to Malaya. But later on 28 September when the United Kingdom high commissioner made an informal approach to Chifley on the question of military assistance, Chifley firmly denied the request.45

The distance between government and opposition in matters of foreign policy is well illustrated by the debate on international affairs in February 1949. Evatt reaffirmed that support for the United Nations was the cardinal principle of the government’s foreign policy. The United Nations existed to prevent war, to adjust and settle disputes ‘not arbitrarily but in accordance with the principles of justice’, and to solve international problems of economic and social significance. He rejected the

notion that there might be a conflict of interest between support for the United Nations and support for the British Commonwealth, since the Commonwealth itself was bound by the principles of the United Nations charter. He argued that wars could be prevented by removing their underlying causes, and that international disputes could be settled by reference to a standard of what was 'just and right' rather than to what was merely 'expedient'. And he dismissed the idea that the North Atlantic Pact was an alternative to the United Nations, arguing that it was merely an adjunct to the UN. He hoped that the proliferation of defence pacts would not lead to a situation in which two great power blocs were 'struggling for mastery, and without a forum at which they can meet and discuss their differences with a view to preserving peace'.

Menzies replied on 15 February. He described Evatt's approach to international affairs as 'completely theoretical' and 'completely legalistic'. He censured Evatt for contrasting 'justice and expediency, as if justice were some ideal quantity existing at large, and criticizing force and expediency as something to be rejected because they were expedient.' Menzies used the example of the Berlin dispute as an example of a problem solvable only by the 'expedient that it has evoked from the people of the western powers.' Moving to a general view of the world situation, he argued that despite the United Nations, 'the world is in a ferment and peace at this very moment hangs on a thread.' Menzies then made a point which he had made countless times before: that if aggressive attacks by a great power were to be restrained at all, they would be restrained, not by the Security Council of the United Nations, but by some other great powers acting together, not under the charter, but in spite of the existence of the charter. Consequently Australia's major task had to be to build up the strength of the British Commonwealth and of the United States.

Menzies asked the government what it was going to do about the Soviet Union in Europe. He condemned the intervention of the General Assembly and of Evatt in the

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46 CPD, 201, 9 February 1949, pp.76-87.
Berlin dispute. The Berlin blockade, he said, was an act of war, which had to be met by the resolute resistance of the western allies. Finally, he asked what the government's attitude to the North Atlantic Pact was, having perhaps, some inkling of the government's bitter attack on the policy of Western Union in 1948. 48

Percy Spender, the Liberal member for Warringah, reinforced his leader's comments:

The minister for external affairs has thrown into highlight two matters, one that the government's foreign policy is based solely on the United Nations, and the other that the opposition, which directs itself to the realities of the situation, wants some support other than the United Nations for the difficulties that lie ahead...In my view [Evatt] has been so carried away by internationalism, that either he has lost sight of or is unmindful of the strategic and vital considerations that affect Australia.

Spender argued that if one great power in the United Nations refused to resolve its differences under the settled procedures of the United Nations charter, the whole organisation would fail in its primary objective of preserving peace. Thus the western nations should fall back on defensive alliances: the Atlantic Pact and perhaps a Pacific Pact built on similar lines. The Australian government, he argued, should leave the path of internationalism and direct itself to the vital strategic interests of Australia.49

That the Labor government was determined not to depart from its internationalist principles is illustrated by the consistency of its policy towards developments in Asia. Japan's easy conquest of Singapore in 1942, its capture of thousands of Australian prisoners of war, and the bombing of Darwin, had inflamed the minds of Australians. The Chifley government, supported by most Australians, resolved that Japan had to be subdued, punished, and rendered unable to menace Australia's security again.

At the end of the Pacific war Evatt had two major concerns about Japan. First he feared that Europe and Japan would become so absorbed in their own concerns, that

48 Ibid., pp.272-3.
Japan would gradually be able to regain a position of influence and power. Second, he feared that the great powers would collude on Japanese policy to the detriment of Australian interests. To gain an effective voice in allied policy toward Japan, Evatt arranged for Australian participation in the British Commonwealth Occupation Force (BCOF) and for Australian membership of the Far Eastern Commission. Evatt saw cooperation with the United States in the wartime occupation of Japan as a means of perpetuating the wartime alliance of Pacific nations, and ultimately of creating a broader regional security system. While Evatt was hostile to security pacts against the Soviet Union, he was working towards a security pact with the United States in the Pacific. Evatt disliked security pacts under article 51 of the UN charter directed specifically against the Soviet Union. Russia was a member of the Security Council, and such pacts undermined the United Nations and made war more likely. What Evatt envisaged was a Pacific alliance under article 52 of the charter, subject to a Security Council veto, and not directed against any specific nation except Japan, which was an aggressor nation and outlaw state and therefore not privileged by the protection of the United Nations charter.

Evatt’s plans to give Australia a voice in the peace settlement went awry. The Americans in 1947 displayed the unmistakable intention of acting unilaterally about Japanese affairs, with scant regard for Canberra’s concerns, and bypassing the Far Eastern Commission and the Allied Council. To pre-empt unilateral action by the United States, Evatt helped to set up a British Commonwealth conference on Japan, mid-way through 1947. The conference produced a sixty-two page draft peace treaty full of restrictions on Japanese rearmament, affirmations of reforms inspired by the allied occupation, and the establishment of a supervisory commission made up of all the nations which had fought against Japan. 50 The United States would chair the commission, which would decide the extent to which military occupation would continue after the signing of the peace treaty. In effect, as Roger Dingwell has argued,

50 'Draft treaty of peace with Japan’, PCPS-D14, 9 July 1947, CRS A1838 536/7, AA.
the draft treaty perpetuated a smaller and much more internationalized version of the military government of Japan (Supreme Commander Allied Powers), while purporting to restore Japan to full independence. 51

As the cold war progressed the Americans became more and more inclined to shelve the Japanese peace treaty. Evatt attributed the delay partly to the fact that the Soviet Union would claim a right of veto in connection with the Japanese peace settlement. A more cogent reason for the delay, though, was the tension between the Soviet Union and the United States. A body of opinion was forming in the United States that Japan should be given the capacity to rearm, so that she could be used as an instrument in the future struggle between America and the Soviet Union. Evatt totally disagreed with this idea, arguing that the ‘safety of Australia cannot be secured against a repetition of what took place in 1942, unless the broad principles of the Potsdam declaration are carried out, and Japan’s capacity to wage war is not restored.’52

The strategic considerations of America’s foreign policy did not change Evatt’s policy towards Japan. The Australian government continued to assert the need for a Japanese peace treaty in 1948 and 1949. On 16 June 1948, Evatt declared that a rearmed and independent Japan would be a menace for Pacific countries.53 To him peace and stability in the Pacific and in Asia was dependent on peace and stability in Europe – on the thawing of the Cold War. 54 In June 1949 he argued that policy in relation to Japan should not be determined solely as a by–product of the western powers’ relationship with Russia. He thought it a fallacy that a rearmed and independent Japan would automatically do the bidding of the western powers in any future struggle in the Far East. He disagreed with three articles of American conventional wisdom: that Japan was incapable of starting another war for at least fifty

52 Evatt’s statement in the house of representatives, 8 April 1948, CRS A1838/2 535/3 Part 2, AA.
53 Ibid., statement in the house of representatives, 16 June 1948.
54 Ibid., extract from Dr Evatt’s statement prior to his departure from Sydney to the London and UN conference, 22 July 1948.
years; that reparations would prevent Japan's return to economic self sufficiency; and that Japan was of vital strategic importance in a future war with Russia.  

By mid 1949 it was clear to the Chifley government that the Americans were postponing the Japanese peace treaty and merging the issue with the wider world problem. The Australian government's basic objective in Japan was to see that the democratic reforms recommended by the allied powers became firmly grounded so that Japan would not re-emerge as an aggressor. America's basic objective was to see that communism did not develop in Japan and that Japan would re-emerge as a self-supporting state which would reinforce American policy in the Far East. The Chifley government's fear was that these objectives might conflict: that the Americans would concentrate on the economic recovery of a non-communist Japan at the expense of the democratic and de-nationalizing reforms which would ensure that Japan did not re-emerge as an aggressor. The Australian government had first hand evidence, in China and Korea, of how an American policy of unqualified anti-communism had simply bolstered corrupt ultra-conservative governments, retarded social and economic reform, and provided the conditions in which communism flourished. Yet there was little that could be done. Patrick Shaw, the head of the Australian mission in Japan, thought that Australia could only acquiesce in the policy of 'peace without a treaty' and withdraw the Australian contingent from the British Commonwealth Occupation Force.  

But despite America's changed policy, Evatt continued to talk the language of 1947: that all problems would be solved if there was an immediate peace treaty to which Australia would subscribe as a party principal because of her efforts in the Pacific war and because of her geographic position. He held to this position despite external and internal criticism. Defence's view, for example, was that it was to

55 'Prospect of a Japanese peace settlement', L.R. McIntyre, Pacific division of external affairs, CRS A1838/2 553/2 Part 2, AA.
56 Ibid., departmental despatch No. 85/1949 from the Australian mission in Japan, 5 August 1949.
Australia’s strategic advantage for the occupation of Japan to continue on a friendly basis without a treaty. Defence thought that it would be calamitous if, after the peace treaty, Japan were to come under Soviet domination and cut loose in the South East Asian and west Pacific areas. Defence had again come out against the government, maintaining that the imperative of thwarting the Soviet Union, militated against the conclusion of a peace treaty, which had been one of the chief aims of Australian foreign policy.57

The Chifley government’s attitude to the defence of Hong Kong illustrates its commitment to internationalist principles. On 26 May 1949, in the face of the Chinese communists’ march southwards, the British cabinet met and decided to send extra forces to Hong Kong and to ask the dominions for assistance. Chifley replied that any request for assistance had to be considered by full cabinet, because the decision might involve Australia in a war with China. He urged the British to negotiate with the communists, resume trade with them, recognise the communist government immediately, and return Nationalist Taiwan to the mainland. Despite this negative reply, the Commonwealth relations secretary sent Chifley a list of Britain’s probable requirements from Australia. It included one fleet carrier, two destroyers, two landing ships, and one army battalion from Japan. But the Australian government decisively rejected the British government’s probing. Cabinet feared that the United Kingdom was risking a major war with China and therefore refused Australian involvement. Chifley intimated that he would prefer not to receive a request for warships or land forces, since the reply would have to be in the negative. Luckily for Chifley, the opposition failed to learn of the United Kingdom’s plea for Australian help in defending Hong Kong, otherwise it would certainly have made an issue of another instance of the government’s ‘softness on communism’.58

57 Ibid., Australia’s future policy to Japan’, 12 August 1949.
58 E.M. Andrews, Australia and China, Melbourne, 1985, pp.135-8. Ewen was more enthusiastic about assisting the United Kingdom in Hong Kong, but Chifley and Burton overruled him.
Later in 1949 the Labor government had to decide whether or not to recognise the communist government of China. This was one more communist related issue raised at a time when the government was under increasing pressure from an opposition which was using the communist threat in the campaign for the general election. By October both the United Kingdom government and the department of external affairs were in favour of recognizing the communist regime in China. As Eric Andrews has argued, the government clearly wanted to recognise the communist regime but could not do so in the climate of a general election. It decided to postpone the issue until after the election. 59 The press was waiting and quite capable of mounting a further anti-communist campaign on the issue of the recognition of China. And the opposition would have been handed dynamite to use against the government. Chifley later regretted having delayed in recognizing the communist regime — a decision which was a tactical concession to ‘expediency’ rather than a total departure from ‘principle’. 60

Meanwhile Chifley had authorized a visit of British defence planners in July 1949, on the condition that their discussions were confined to areas previously approved by the Australian government. He did not want the defence discussions to proceed on the basis that Australia would make a military commitment to the Middle East while American plans for the Pacific were unknown. Attlee acknowledged Australia’s ‘vital’ interest in the Pacific but felt that the discussions could not be delayed.61 The British planning team glossed over Chifley’s concerns, impressing upon Australian defence officials the strategic importance of the Middle East and arguing that no further information from the United States was needed for Commonwealth strategic planning.62 Moreover the Australian defence department

60 Crisp, op. cit., p.294.
61 Attlee to Chifley, 4 April 1949, CRS A816 14/301/381, AA.
62 Records of the discussions of the joint planning team, CRS A816 14/301/381, AA.
provided the government with an assessment of the effect of the communist revolution in China and of the spread of communism in South East Asia on western interests. A report of the joint intelligence committee concluded that communist China might well ally itself with the Soviet Union; and that in wartime it was possible that these powers combined could overrun South East Asia. However the committee thought that Soviet grand strategy in the Far East would be defensive. The only land operation considered likely against the ANZAM area was a Chinese communist attack on Malaya through South East Asia. But this, they concluded, could not happen before June 1950, and would not pose a threat to the security of mainland Australia. 63 External affairs criticized the complacency and wishful thinking behind the presumption that there was no significant threat to Australian security in Asia and that Australian forces could be diverted elsewhere.64

Evatt was incensed with the discussions, and hearing the Australian chief of staff talk of the inevitability of war, he exploded. He drafted a letter to Chifley decrying the tendency for political and service thought to develop on different lines, the former contemplating the possibility of war but taking all practicable steps to avoid it, the latter accepting the inevitability of war and seeing all overseas political developments as part of a struggle in which the belligerents have already been chosen.

He declared that defence thinking and planning was based on the assumption that Australian troops would be sent to the Middle East. This line of thinking was followed to the exclusion of all others, even though the disposition of Australia’s war effort was a political decision which could only be taken in the light of the circumstances of the time. He also criticized defence for making strategic assessments based on political assumptions and judgments which were really the function of cabinet or the council of defence.65

63 Joint intelligence committee appreciation 5/1949 ‘Strategic planning in relation to British Commonwealth defence – probable form and scale of attack against and within the ANZAM area’, 15 July 1949, CRS A1048 T4 DL 47/5/1, AA.
64 Memorandum, 26 July 1949, CRS A1068 DL 47/5/1A, AA.
65 Evatt to Chifley, 21 October 1949, CRS A1068 T4 DL 47/5/2B, AA.
Conclusion

In the last three years of the 1940s the Cold War intensified: the world divided into two armed camps, and people speculated about the possibility of a third world war. The United States government began a policy of containment of the Soviet Union, and the British government abandoned internationalism in favour of western European union and an anti–Soviet alliance. But the Australian Labor government refused to bring its foreign and defence policies into line with British and American cold war attitudes. It reinforced its reliance on the United Nations to resolve international disputes and to prevent war. Consequently in 1948 the Australian government vigorously opposed Western Union in particular and anti–Soviet defence pacts in general. Evatt softened this stance to some degree in October 1948 but continued to insist that British Commonwealth foreign policy should not be conducted on the basis that the Soviet Union was the enemy. Prime minister Chifley was equally insistent that Australia could not neglect the Pacific and South East Asia and make a military commitment to fight the Russians in the Middle East.

The Chifley government felt that considerations of foreign policy should override military plans, and that considerations of strategy should not prevent international problems being solved on the basis of 'justice' through the United Nations. Evatt’s intervention on behalf of the General Assembly in the Berlin dispute was an example of this belief. Evatt and external affairs fought against both the Australian department of defence and the United Kingdom government over the view that Australia should adopt the strategy of fighting Russia first. Evatt insisted that Japan and China posed a greater threat to Australian security. In the first instance he proposed a programme of non–military assistance to South East Asia to counter Chinese influence. And in the second case he wanted a Japanese peace treaty which safeguarded Australian interests. The Chifley government did not give way to war fears: it refused to enlarge the defence programme; declined to assist the United Kingdom against communist insurgents in Malaya and a threatened Chinese invasion of
Hong Kong; and vetoed the idea of reintroducing compulsory military training and changing the conditions of service in the Australian army so as to facilitate mobilization of Australian troops overseas in a full scale war. The Liberal and Country parties, however, wanted a comprehensive change in Australia’s foreign policy: the abandonment of internationalism, in exchange for playing a role in the western alliance against the Soviet Union. The opposition parties would replace fear of depression with fear of war as the basis of Australian government policy.
CHAPTER FOUR – THE DOWNFALL OF THE CHIFLEY GOVERNMENT

The Chifley government had based its hopes for the preservation of full employment in Australia on international collaboration. Similarly in foreign policy the government saw internationalism as the chief hope of maintaining world peace and security. But just as Evatt’s internationalist foreign policy was being threatened by the onset of the Cold War, so the government’s policy of maintaining full employment and a stable rate of development were marred by the dollar shortage and a recession in the United States. And on a purely domestic level, the aim of maintaining full employment without inflation was set back by two main factors: a debilitating strike in an already inadequate coal industry; and the government’s inability to continue wartime controls into the postwar period and to control inflation. These factors taken together – the challenge of communism to the government’s foreign policy, problems associated with the dollar shortage and the United Kingdom’s postwar economic decline, and the domestic economic setbacks suffered by the government provide the main reasons for Chifley’s defeat. The unpopularity of his attempted nationalisation of the banks was certainly a contributing factor, but I place less emphasis on this issue than the current orthodoxy. It cannot be said that the 1949 election was a struggle between a Labor government seeking to win a mandate for socialization and an opposition pursuing the opposite course of liberal capitalism. Rather, the contest was moved by Labor’s desire to adapt Australia’s wartime economy to the peacetime imperative of maintaining full employment in troubled international conditions, and the coalition’s urging the need to fight inflation without extraordinary Commonwealth powers and simultaneously to prepare for war.

The Failure of Chifley’s Domestic Economic Strategy

Labor’s defeat in December 1949 must be set in the context of the failure of its broad economic strategy. At the end of the war the government envisaged a postwar boom of two or three years followed by an economic downturn caused by lower demand and
lower prices for Australian primary products. Given these expectations the government’s broad economic strategy was to restrain the postwar boom so as to avoid weakening Australia’s ability to respond to recession. This would be done by building up Australia’s international reserves and establishing a programme of investment which could be sustained in the face of declining economic conditions abroad. The government hoped to restrain the inflationary boom expected to precede the depression by a coordinated programme of budget surpluses, the building up of stabilization funds for rural industries, banking policy, and price control. However the government’s economic predictions were incorrect: boom conditions were not reversed, and investment and capital inflow increased:

In practice governmental anti-inflationary controls were progressively weakened. It became increasingly difficult to limit public and private investment programmes; price and capital issues controls became more and more ineffective; the policy of building rural stabilization funds had to be abandoned because of political difficulties; and growing government expenditure and pressure for taxation relief reduced the deflationary effect of the budget. While banking policy remained restrictive, it could make no substantial impact on the basic situation, but at best could prevent unwise banking policy making it worse. Finally, the difficulties of limiting the investment programme were intensified by the adoption of a heavy immigration programme.1

On 27 May 1949 the department of postwar reconstruction produced a comprehensive report reviewing Australia’s economic policy. The report noted three important features about the Australian economy in the middle of 1949. The first was strong inflation. Prices and wages had been going up in Australia since the middle of 1947 at the rate of fifteen per cent per year, owing to the relaxation of price stabilization controls, the doubling of the incomes of Australian exporters since 1946, and a large investment programme. The second was a mild recession in the United States of America which had the capacity to worsen and spread to Australia. The third feature was unbalanced development in Australia. Industrial development, the report argued, was top heavy. Growth in the economy was being held back by bottlenecks in

such key items as coal, electric power, steel, and building materials. These shortages resulted from specific problems of production and industrial relations in the coal industry and because of the general failure of basic industries to keep pace with the rest of the economy.  

The report envisaged that, within twelve months, the decline in private investment in the United States would offset current American defence expenditure sufficiently to bring about a serious economic slump. Australia would suffer, although not as severely as in 1930. This was because full employment policies would operate in the United Kingdom, and after some delay, in the United States; because the non-dollar world was partially insulated from dollar price trends by currency restrictions; and because Australia's export income was partially protected by long-term food contracts with the United Kingdom and by an international price stabilization scheme for wheat. Prices in Australia were rising much more steeply than overseas, so when the depression came, there would be a much sharper decline in Australian investment plans. Adding to Australia's vulnerability to depression was the impact of unbalanced development. The metal and engineering trades had increased by 85 per cent since 1939, owing to the successful reconversion of wartime munitions production to civilian needs. But Australia's basic industries had failed to keep pace. This was evidenced by coal shortages, power blackouts, interruptions to the supply of materials, transport hold-ups, a housing shortage, and shortages of sewerage and telephone facilities. The structure of the economy was therefore such that it was extremely vulnerable to external shock.

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2 'Review of economic policy', 27 May 1949, CP 286/2 Bun6/1531, AA.
3 Ibid., 'The greater the rate of inflation, the more serious the reversal is likely to be. The slump in 1921 in Australia followed a postwar inflation no more violent than that of the past two years, and took place very soon after our overseas prices ceased to rise. Trade union unemployment rose from 4% to 10% within six months, simultaneously with the development of unemployment in UK and USA, and before there had been any significant drop in our export or import prices'.
4 Ibid.
The Labor government had great difficulty in implementing its economic policy. One reason for this lack of success was the failure of its schemes to stabilize the incomes of primary producers. High prices for primary products overseas had raised Australian prices above their pre-war levels. Increased export incomes fuelled inflation in Australia. The problem was to insulate the domestic economy from the effect of increased prices overseas and simultaneously to develop schemes which would stabilize export incomes in the future when export prices fell to much lower levels. This required four things: minimum guaranteed prices supported by an ‘equalization’ fund, built up when overseas prices were high and run down when low; some control of the costs of primary producers – including control of land values; control of production, without which unmarketable surpluses would become a chronic condition in price guaranteed industries; and the power to acquire or dispose of crops. In general, apart from the negotiation of an international wheat agreement, the Chifley government failed to implement stabilization schemes. The reasons for this failure were three. First, the Commonwealth had no constitutional power to control production of agriculture or to acquire crops. Secondly, growers with prospects of high export returns did not want stabilization if it meant an impost on exports. And thirdly, the states had not been willing to cooperate with the Commonwealth to legislate for the control of production and the acquisition of crops.5

To take the example of wool, by agreement between the United Kingdom, Australia, New Zealand, and South Africa, a ‘floor’ had been put under the wool price. But as a result of the high demand for wool at auctions, it had not been possible to establish control over the high price of wool, and therefore to minimize the inflationary impact of this high price on the general Australian price level. The government’s investment and employment committee (I & E) noted on 6 August 1947 that the failure of the government to introduce stabilization schemes ‘makes other

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5 ‘Stabilisation of primary producers’ incomes’, Investment and Employment committee (I & E), 6 August 1947, CRS A571 47/1901 Part 3, AA.
efforts to maintain stability in the economy to an appreciable extent ineffective'. It suggested alternative anti-inflationary devices such as a tax on export incomes and appreciation of the Australian pound. Appreciation had the effect of making Australian exports dearer and imports cheaper. But Chifley rejected these ideas, arguing that appreciation in particular would be disastrous because export prices would fall when the recession came. Appreciation on top of a recession would slash Australia's export income and encourage a flood of imports into the country at the same time that it was experiencing a recession.6

In a cabinet agendum of 8 December 1947, Chifley argued that Australia had reached a stage at which, with all available labour employed, a huge demand for labour remained unsatisfied. He argued that Australia's resources were spread too thinly over too wide a field. The result was that basic industries like the coal industry could not attract enough labour. There could be no thought of returning to a comprehensive system of wartime controls even if this were constitutionally possible. Inflation could only be stopped when supply equalled demand at current prices. Price control might help but without the support of wage pegging and the control of costs of production, it could not be fully effective. Moreover subsidies on the prices of essential goods could only be retained for a short while. 7

Chifley considered the restriction of demand as a way of controlling inflation. According to Keynesian economic theory governments should control inflation by raising taxes and limiting government expenditure and by restricting bank advances to the public. Chifley's policy was that Australian taxation should be maintained as far as practicable, and that, 'from a strictly economic viewpoint there is a strong case for imposing increases in taxation as has recently been done by the United Kingdom'. But although there was a strong case for increasing taxation according to Keynesian

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6 'Stabilisation of primary producers' incomes', I & E 16/47, 6 August 1947, CRS A571 47/1901 Part 3, AA.

7 'Economic trends and prospects – survey by the investment and employment committee', cabinet agendum 1413 CRS A571/1 46/3926, AA.
canons, he refused to do so. As F.H. Wheeler pointed out, Chifley approached taxation with the long term aim of reducing taxes from their wartime peak to more normal levels, and not from the Keynesian position that taxation should be the main instrument of stabilization policy and raised or lowered according to whether the economy was experiencing rising prices or depression. He was also fearful that the opposition would make a great deal of mileage out of high levels of taxation just as it had done in the 1946 election. 8

As Greg Whitwell has shown, from 1947–8, with the immigration programme beginning, Commonwealth government expenditure accelerated rapidly. The inflationary effects of this rapid expansion could only have been offset by substantially higher taxation. Yet despite strong increases in capital expenditure over this period, personal income tax cuts averaging 16.6 per cent were announced in 1948, with further tax cuts averaging 23 per cent announced in February 1949. The government refused to use taxation as a weapon against inflation and was further hampered when a referendum to get Commonwealth control over prices failed in 1948. Its economic strategy was already in serious trouble when the national coal strike began. 9

The National Coal Strike

The government's economic strategy received a further blow when the communist led mining unions went on strike in the middle of 1949. Occurring in the depths of a severe winter, in an economy particularly dependent on the domestic coal industry, the strike's devastation was immense. The strike directly challenged the established system of conciliation and arbitration and the authority of the Labor government which endorsed the system. Moreover that government had to fight on two fronts. As well as striving for community and union support in its policy of breaking the strike, it was forced on to the defensive by the Liberal and Country party opposition, whose

8 Meeting of public service officials, 1 March 1949, CRS A571/1 47/1909 Part 6, AA.
9 Whitwell, op. cit., p.94.
advocacy of tougher industrial and anti-communist policies began to gain broad community support.

Towards the end of 1948 the mining unions became impatient with the lid which the Labor government held on wage rises – a policy enforced through the arbitration system. With a recession looming, they felt that they should maximise their gains during 1949. Moreover they sought to achieve their aims through direct bargaining, as well as through conciliation and arbitration. The central executive of the miners' federation, the principal mining union, prepared a log of claims, which it submitted on 22 April 1949 to the Commonwealth and state governments, the colliery proprietors' association, and the joint coal board. This joint coal board was an authority established by the Commonwealth and New South Wales governments to supervise, regulate, and modernize the coal industry, and to ensure the fair distribution of coal from New South Wales to the other states. The miners reduced their claims to four main points: long service leave, a 30/- a week pay rise and the provision of pit and town amenities.

There are two versions of the 1949 coal strike. The first is one which gained currency at the time of the dispute, particularly in the Commonwealth government's anti-strike propaganda and in the subsequent debates over the Communist party dissolution bill. According to this version, the strike was a conspiracy of the Australian communist party to disrupt Australia's fuel supplies in a critical period of the cold war, and to discredit the Labor government and the conciliation and arbitration system. Australian communists themselves gave credence to this interpretation by vehemently attacking Labor party leaders and by pronouncing the mining unions to be their main industrial weapon. The opposite version, recently expounded by Tom Sheridan, is that the mining unions legitimately attempted to use their industrial bargaining power to gain concessions from unyielding employers who were being supported in their attitudes by an obdurate Commonwealth Labor government. Sheridan argues that the question is not why the miners, urged on by the communists, acted as they did, but why
the Commonwealth government refused to compromise with them so as to avoid a wholesale disruption to the economy.  

Sheridan’s account is a valuable corrective of the crude conspiracy theory. He makes three points about the relationship of communism to the executive council of the Australian Coal and Shale Employees’ Federation (ACSEF). Firstly, the federation’s council operated in an environment considerably to the left of the majority of Australians. Thus a ‘moderate’ in the ACSEF would be considerably to the left of the majority of workers in other industries. Secondly, miners were militant long before the existence of the Australian Communist party in the industry. And it was often the case that the rank and file ACSEF member was more militant than his communist official. Thirdly, Sheridan argues that the communists originally sought to restrain the ACSEF from militant action in 1949, but seeing the mood of the miners, and favourable conditions in which to strike, they used the dispute as an opportunity to discredit the Labor government and its policy of ‘reformism’.  

Nevertheless Sheridan takes revisionism too far in sheeting home the blame for the strike to the Chifley government.

At meetings between the coal mining unions’ council, the proprietors, and the joint coal board, the coal owners rejected all points in the miners’ log of claims, except the possibility of wage rises. At a meeting on 19 May, however, the minister for shipping and fuel, senator Ashley, made a tentative offer of Commonwealth support for miners’ long service leave. And in subsequent negotiations the coal owners softened their stance by recognizing long service leave in principle, provided that it was granted for continuity and not length of service, and subject to the miners agreeing to the mechanization of mines, the abolition of compulsory retirement at sixty, and enforcement of union discipline. Later on 24 May, the chairman of the joint coal board

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10 Tom Sheridan, Division of Labour, Industrial Relations in the Chifley Years, Melbourne, 1989, Chapter 11.
proposed a compromise: an attendance bonus in lieu of wage increases and a long service leave scheme based upon the principle of continuity of service.\textsuperscript{12} The joint coal board was concerned to link improved conditions for the miners with higher productivity and better union discipline. The miners rejected the compromise and called aggregate meetings for 2 June.

At this stage the special arbitral tribunal for the coal industry intervened. J.F. Gallagher convened compulsory conferences of the parties to the dispute. Gallagher’s efforts at conciliation failed and simultaneously the coal owners withdrew their recognition of the principle of long service leave and the Commonwealth government revealed that it would not directly cover the cost of long service leave out of general revenue. On 14 June Gallagher repudiated the coal owners’ rejection of long service leave, but indicated that he would grant an award for long service leave based on continuity of service. The miners’ leaders now thought that their claims were suffering from the process of arbitration. They announced stop–work meetings for 16 June, withdrew their wage claims from arbitration, and refused to accept anything less than the totality of their demands. Gallagher responded by issuing an order restraining the miners from calling aggregate meetings, and holding off his announcement of an award for long service leave.\textsuperscript{13}

Sheridan sees the key to understanding the 1949 coal strike as being to see it as the climax of a struggle by the joint coal board and the coal industry tribunal to keep the lid on the miners’ wage demands and to take away their right to strike. The coal owners were being encouraged by the arbitrator to apply for an order to prohibit the use of the miners’ industrial strength by calling aggregate meetings. And all the miners

\begin{itemize}
  \item \textsuperscript{11} Ibid., pp.269–71; Phillip Deery (Ed.) \textit{Labour in Conflict: the 1949 Coal Strike}, Sydney, 1978, pp.38–9; Cablegram 112 joint coal board to the office of the London high commission, 1 July 1949, CRS A461 DA 351/1/4,AA.
  \item \textsuperscript{12} ‘Compromise proposal submitted by joint coal board to a conference of owners and unions held in Sydney on 24 May’, ACSEF files, E165/3A ANU Archives of Business and Labour.
  \item \textsuperscript{13} Sheridan, \textit{op. cit.}, pp.274–84.
\end{itemize}
were doing was to try to secure a justified advancement in working conditions before
the economic bubble burst and depression came. Sheridan makes the further point that
had the ACSEF known that the Commonwealth government would not seek to
conciliate in the face of a disruption to coal supplies, it may well have adopted a
different tactical position. The ACSEF acted on the assumption that it was in a position
of unassailable strength and that the Commonwealth would act speedily to settle the
dispute.\footnote{14 Sheridan, \textit{op. cit.}, p.282.}

The miners' leaders had good reason for thinking that Chifley would crumble
before the threat of a general coal strike. A \textit{Sydney Morning Herald} commentator
observed that 'even the most optimistic party man, even the sanguine Mr Chifley
himself, admits that the closing down of industry in the depths of winter and
immediately before the election, could swing Labor out of office'. But he was in a no
win situation. If he appeared to 'appease' the miners, he would put a powerful weapon
into the hands of the opposition and risk a storm of public indignation that could wreck
his government. If, on the other hand, he accepted the miners' challenge and faced a
showdown resolutely, there was the possibility that there would be no coal, dislocation
of industry, and again, a storm of public indignation against the government.\footnote{15
\textit{Sydney Morning Herald (SMH)}, 19 June 1949.}

However as Dedman observed at the time:

\begin{quote}
when a central government in a federated system has to examine an
emergency situation, such as we are now experiencing, it must consider not
only what it would like to do in the circumstances, but also what it has the
constitutional power to do.
\end{quote}

He went on to point out that during a meeting between the prime minister, the
attorney-general, the minister for fuel and shipping, the minister for the interior, and
the solicitor-general, the whole field of action available to the government was
discussed. The result was that the government saw only one course of action which would bring the strike to a speedy end: to freeze the strikers’ funds.16

The Chifley government had intervened to settle an industrial dispute on three previous occasions. In 1945 it had used the national security regulations to rescind a contentious clause in an award of the New South Wales industrial commission. In the following year the Waterside Workers’ Federation threatened to strike when they were made to handle ‘double dumped’ bales of wool – that is bales compressed to handle double their normal volume. Then in 1948 the government headed off a coal strike by issuing a direct order to the joint coal board to take a softer line in negotiations to which it was a party.17 In the first instance the Commonwealth settled the dispute by recourse to the defence power, a power no longer available to the government. In the second case it was able to prevent a strike on the waterfront by use of its power to regulate trade. And in the final instance the government issued a directive to an instrumentality of the Commonwealth and New South Wales governments. These cases indicate that the Chifley government directly intervened in industrial disputes rarely and then only when it could speedily settle a dispute by use of a legitimate Commonwealth power. It was inconceivable that Chifley would have attempted to compromise the decision of an independent arbitral authority. It was because the mining unions were relying on this that their strategy failed.

The Commonwealth government’s role in the coal dispute was thoroughly investigated in 1948. On 22 September of that year, the Coal Mining Unions’ Council (CMUC) had visited Chifley to discuss the matter of long service leave. The department of treasury’s view was that neither the Commonwealth nor the New South Wales governments should introduce a long service scheme in the coal industry.18 It had three reasons for this view. The first was that long service leave had been until that

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17 SMH, 1 August 1949.
18 Treasury memorandum – long service leave for coal miners, by H. Goodes, 5 October 1948, CRS A571/1 48/432, AA.
time an employer–employee matter; it would have been a significant innovation for a government to introduce it on an industry basis for non–government employees. Sheridan is therefore wrong in implying that there was nothing radical about the miners’ demands. The second reason was that if long service leave were introduced by the government in the coal industry, employees in other industries would inevitably seek similar treatment. And the final problem for the treasury was the technical difficulties associated with long service leave in the coal industry: the difficulty of employees drifting from one employer to the other; the manpower shortages which would result when long service leave became available; and the problem of financing the scheme.

Treasury pointed out that the Commonwealth had no constitutional power to grant long service leave to the coal industry. Only the coal industry tribunal could make such an award: one which would bind individual colliery owners and distribute the burden of the cost of the scheme fairly. The New South Wales parliament could legislate a long service scheme for miners in its own state, financed by a Commonwealth levy on coal; but the Commonwealth levy would have to be Australia wide and the obvious corollary would be that the scheme would have to be extended to all the coal mining states – which would require complementary legislation in all the states concerned. If, alternatively, the Commonwealth financed a New South Wales scheme from general revenue, it would be difficult to withstand pressure to extend the concession to other industries. Long service leave would become, in effect, a social service payment of the Commonwealth. Treasury argued that if long service leave were to be introduced at all, it should be left entirely to the states, and that it would be unwise even for the states to get involved. This was because the states would have to charge the cost of the long service leave to the coal owners, who would in turn pass it on to consumers. The states would then be under pressure to extend long service leave

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19 Sheridan, op. cit., p.273.
20 Treasury memorandum, 5 October 1948.
to all industries within their boundaries, and pressure would grow Australia wide for long service leave. Treasury suggested that:

the Combined Mining Unions' Council be informed that the Commonwealth lacks the constitutional power to introduce a long service leave for the coal industry and that, in any case, to do so would involve a step difficult to justify because it would single out one group of workers for treatment not previously extended by a government to non-government workers.21

The Commonwealth Labor government had no direct power to legislate for long service leave scheme in the coal industry. It could finance a long service leave under state legislation or under a Commonwealth award. Because of the difficulties involved in financing long service leave under state legislation, the government rejected that option. But it had not set itself against the principle of Commonwealth financing of long service leave in the coal industry, if owners and miners could agree on a scheme through the process of conciliation and arbitration. On 19 May senator Ashley told the miners that: 'if there is agreement, or if long service leave was granted by an award, the Commonwealth would play its part in financing the scheme'. 22 Sheridan argues that, later in June, the government reneged on this promise, thereby justifying the miners' withdrawal from arbitration. In fact the joint coal board informed the miners on behalf of the government that: 'all it is prepared to do is assist with appropriate financial and legislative action to ensure that the cost of the scheme is borne by the coal industry; not that any part of it should be borne by the general taxpayer'. 23 The government was clarifying to the miners that it would finance long service leave from an excise on coal rather than from general revenue. It was not withdrawing a financial guarantee for long service leave.

When on 31 May, Gallagher was first threatened with aggregate meetings, he responded severely:

21 'Long service leave for coal miners', 5 October 1948.
22 Sheridan, op. cit., p.362 note 66.
23 Ibid., p.278.
I have this to say: that, if you stop on Thursday and anybody in this country, the government or any other authority, gives you long service leave, I resign immediately out of this office. I shall never deal with your claims again. That is on record now and I shall make that public. If the government gives you long service leave after a stoppage on Thursday, it sells me...24

Gallagher had it in mind that the coal dispute could be settled over his head by the Commonwealth and New South Wales governments acting together. The miners themselves were relying on an erroneous assumption: that either Gallagher would cave in, or the Commonwealth government would abandon the coal industry tribunal and try to settle the dispute in conjunction with the New South Wales premier, J.J. McGirr. But to try to resolve the dispute himself would mean that Chifley would have to repudiate the principle of conciliation and arbitration in the face of the threat of strike action in an essential industry. This was too high a price to pay. Moreover treasury had advised him against introducing long service leave under state legislation. Chifley could only reinforce Gallagher's ultimatum:

In the circumstances, the decision to stage a general strike on June 27 is a wholly unreasonable and unjustifiable repudiation of conciliation and arbitration at a time when these processes are in actual course of effective functioning. Let this be thoroughly understood: the dispute must finally be settled by the proper industrial tribunal and not otherwise. No threat, no strike, however prolonged, will influence the government’s policy in this matter.25

This interpretation of Chifley’s role in the coal strike differs fundamentally from Sheridan’s. Sheridan is wrong in implying that Chifley was responsible for withdrawing financial guarantees for long service leave.26 He also argues that Chifley deliberately decided on a policy of prosecutions under the fund freezing legislation and thereby prolonged the strike. He contends that although Chifley persuaded the coal owners not to press charges against CMUC officials under the coal industry act of 1946, this was to keep the coal owners and their backwoods attitudes as far from the

24 Ibid., p.217.
25 Age, 21 June 1949.
26 Sheridan, op. cit., p.309.
public eye as possible. Chifley, in Sheridan’s view, wanted the public to see the struggle as a battle between the elected government championing the rule of law and the communist wreckers of the economy.

On 30 June the government rushed through the parliament a national emergency bill. The purpose of the act was to prevent the mining unions from withdrawing strike funds from the banks and to prevent other unions or organisations from assisting the mining unions financially. Unfortunately for the government the miners received a day’s notice of Chifley’s intentions and hurriedly withdrew monies from the banks on 29 June. The arbitration court then became involved in a complex series of proceedings to compel the repayment of monies withdrawn on 29 June. And when the union officials involved refused to cooperate, they were gaoled for contempt of court. Giving the unions a day’s notice seems to have been miscalculation rather than deliberate policy. It resulted from the government’s need to head off an embarrassing adjournment debate in which it was expected that Menzies would be extremely critical of government inaction. And as the Sydney Morning Herald commented on 7 July, up until the end of June Chifley had been hopeful of an early end to the strike if a face saving formula could be found. But the gaoling of union officials stiffened the miners’ resolve to continue their strike. Attorney-general Evatt could only lament that the miners’ leaders ‘were not being dealt with for their industrial action, or for striking, but for deliberate contempt of the judicial power of the Commonwealth’.

During the adjournment debate on 28 June, Menzies made a number of criticisms of the Chifley government’s policy towards the settlement of the strike. His main argument was that the strike was a culmination of a series of events in which the government had been caving in to the communists. Menzies pointed out that in May, he had introduced a motion for a bill which would have made secret ballots mandatory for proposed stoppages of work and not merely in regard to the election of office bearers

28 SMH, 7 July 1949.
or for irregularities. Had such a law been in existence, he argued, the strike might never have occurred. Menzies also castigated the government for not importing enough coal when the joint coal board had stated that coal production in Australia was 1,500,000 tons under requirement. The government therefore had very small reserves of coal with which to maintain essential services while the strike was in progress. He suggested that open cut mines would yield at least 120,000 tons of coal a week if the government would allow other labour to work them. And, finally, he urged the prosecution of the union leaders under the coal industry act. 29 To these criticisms, Chifley replied that when Menzies was prime minister in 1940, and when the miners struck, he had not prosecuted union officials but simply urged them to return to arbitration. Labor was following the same policy in 1949. The issues of moving coal at grass, mining the open cuts, and unloading the Haligonian Duke, a ship importing coal into Victoria, had to be handled with care in order to prevent other unions becoming involved in the strike. Prosecution of unionists was no answer. The only way that the strike could be ended was to persuade the rank and file miners to return to work. 30 In the debate over the fund freezing legislation, Menzies stressed that the government had been faced with the choice of allowing unionists the right to strike or upholding the arbitration system. It had chosen the latter.31 Eric Harrison went further and argued that the coal strike had actually been caused by the failure of the Chifley government to back up the decisions of its judicial instrumentalities. He argued that the government gave the impression that it would not stand up to the communist unions. 32

In July the government ran a series of advertisements in the principal newspapers of the capital cities and coalfield areas. The theme of the first was that the miners went on strike because they had rejected arbitration and that the strike was communist inspired. A second emphasised that the coal industry tribunal had been created at the

31 Ibid., pp.1678–83.
32 Ibid., pp.1708–9.
request of the same union leaders who were now repudiating it, and outlined the gains made by the miners as a result of the speedy and special arbitration machinery. A third advertisement stressed that general trade union opinion was that the strike had to be settled by the machinery of conciliation and arbitration. Most importantly, an advertisement appeared on 10 July which appealed to the miners' loyalty to the British Commonwealth:

Britain and the dominions face crucial problems in the very near future...nothing can be more detrimental to our national welfare than what is now happening on the coalfields of Australia. We can scarcely expect the help and cooperation of others if our own people are not prepared to act fairly in the interests of our country. Miners! stand by your own country. Miners! Stand by Britain. Do not be misled by the communists.

The Effect of the Dollar Crisis on the 1949 Election

The Labor government thought that the coal strike and the dollar crisis together were pushing Australia towards depression. For Chifley, the dollar problem had more capacity to disrupt Australian industry and lower standards of living than did the coal strike. As early as 7 July, he announced stringent restrictions on dollar imports, as part of a drive to conserve sterling area reserves. He announced that 'the dollar committee is examining all supplies which can be gained from non-dollar countries, but which we are now getting from hard currency areas'.

Chifley pointed out to parliament on 7 July that the sterling area's problem was not that it was buying more from the dollar area than in previous years, but that it was earning much less for its exports to the United States than before. The whole group of sterling area countries were not able to sell as much to the dollar area as they had in previous years. Malaya, for example, found not only that the volume of its sales of

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33 Cablegram 2784 joint coal board to London high commission, 4 July 1949, CRS A461 DA 351/1/4 AA.
34 Ibid., cablegram 2785, 5 July 1949.
35 SMH, 10 July 1949.
36 SMH, 7 July 1949.
37 SMH, 8 July 1949.
rubber and tin to the dollar area were reduced, but that it was getting a lower price for its reduced volume of exports. Chifley predicted that Australia would sell a mere 600,000 bales of wool to the United States in 1949/50. Furthermore with Marshall aid to the United Kingdom likely to fall from $1,280 million in 1948 to $940 million in 1949, the sterling area would have $300 million less in the dollar pool in 1949 to pay for dollar imports. He blamed the recession in America for contributing to the sterling area’s economic plight. But the economic position of the world, he thought, was not caused by one particular government. It was caused by a complex set of circumstances: the devastation wrought in various countries during the second world war; economic disequilibrium after the war; and the division of the world into three currency areas – sterling, dollar, and rouble. The only cure for the problem, Chifley argued, was for the dollar area to buy from the rest of the world the equivalent in value of what it sold. Marshall aid had not succeeded in restoring equilibrium to the world, but it had at least prevented complete chaos and contributed to the restoration of economic stability in western Europe. He emphasised that as long as Australia could not earn enough dollars to pay for what it had spent, it would have to get dollars from the United Kingdom:

Whilst we remain in this position, we must endeavour, even if only for purely material reasons, to cooperate with the United Kingdom. However I go further than this. We have strong sentimental ties with the people of the United Kingdom. Many Englishmen have settled in Australia. The United Kingdom is now fighting a stern economic battle. I have not been able to see the light at the end of the tunnel. I see many years of difficulty ahead, but at least we must play our part to assist the United Kingdom in its economic struggle, just as we played our part to assist the United Kingdom in World War II. 38

During the first weeks of August the Chifley government set about effecting the 25 per cent reduction in dollar imports recommended at the London financial conference. Its general policy was to avoid damaging Australia’s economy, and to ensure that essential equipment for developmental projects and industrial expansion should be affected as little as possible. 39 On 19 August cabinet agreed that the other

38CPD, debate on liquid fuel (defence stocks) bill, Vol. 204, 7 July 1949, pp.2186–92.
39 Age, 10 August 1949.
governments represented at the Commonwealth finance ministers’ conference be informed that Australia agreed to reduce its demands on the dollar reserves of the sterling area by a proportion roughly equal to those already announced by the United Kingdom government. Cabinet approved a programme of dollar cuts recommended by the cabinet sub-committee on dollar imports, and authorized it to proceed with a review of the quarterly dollar imports licensing budget within the framework of the general policy approved by cabinet. In addition it appointed Chifley, Evatt, and Dedman to explore the question of alternative dollar finance. In his budget speech on 7 September, the prime minister was able to announce that there would be a ‘substantial reduction in dollar expenditure by government departments as well as cuts in practically all the major categories of dollar imports’. The effect of these cuts would be all the more severe, since the dollar restrictions up to August 1949 were already quite harsh. Chifley added that a full 25 per cent cut was impossible in 1949/50 because of the commitments represented by existing import licences.

In Britain there were no signs that the Commonwealth-wide programme of import cuts was doing much to stabilize sterling. Reserves continued to fall at a rate which would drain the Bank of England in a year. The Americans remained concerned that British policy would inevitably result in the formation of a self contained sterling bloc. The Central Intelligence Agency (CIA) produced a report on 31 August about the implications of the British dollar problem for United States security. It reported that the United Kingdom had been very successful in reconstructing her economy, and increasing her exports, but sales had been increased principally to countries and dependencies in the sterling area, and to the OEEC countries. The result was that Britain’s dollar deficit would remain at a colossal $1.7

40 ‘Report on London financial conference’, 19 August 1949, Curtin, Chifley, Forde, cabinet agenda, CRS A2700/XM1 AA.
41 Ibid.
42 CPD, Vol. 204, 7 September 1949, p.22.
billion each year. So unless the United States continued to make grants and loans, and otherwise to make available to Britain large amounts of additional dollars, living standards in Britain and the sterling area would inevitably decline. The CIA thought that it was out of the question that Britain could lower her costs of production sufficiently to be able to accept non-discriminatory trade and convertibility. It considered it more likely that the British would attempt to build up an integrated non-dollar trading area, comprising much of western Europe, the sterling area, and countries in the Middle East and Latin America. The British would surely not sacrifice their chances of dominating such a ‘third force’ in order to pursue a premature attempt at multilateralism, in the course of which the last of their gold and dollar reserves would probably vanish. And if the British abandoned multilateralism, the Americans would lose, in the British Commonwealth, their most valuable ally. The British would slash their military expenditure, and the United States would have to assume sole responsibility for areas of common strategic interest in the Middle East, South East Asia, and Africa.44

The Americans thought that the British could help to protect the United States’ world position if the British Labour government avoided an economic collapse and abandoned ‘retrogressive’ policies that sealed off the sterling area from the dollar world. To avoid such a calamity the British would have to devalue the pound, fund outstanding sterling balances, and redirect exports to the dollar area. In addition they would have to cut social programmes and reduce inflation and ‘over-full employment’. 45 In order to press this case, Frank Southard, the assistant secretary to the treasury, initiated a special study in the IMF of the worsening dollar gap. The IMF’s draft report supported the American case for devaluation and deflation. 46

45 Hogan, op. cit., p.252.
46 Ibid., p.253.
The Australian government, after reading the report, worried that Australia would be forced to take the same strong medicine as the British. Treasury, which had earlier in the year considered initiating an IMF report on the dollar crisis, strongly criticized the pro-American draft report. It thought that the American policy of reviving western European production, curbing inflation there, and redirecting exports to the dollar area, would be an inadequate solution for the underlying lack of balance between the economies of North America and the rest of the world. H.C. Coombs argued that the Americans had to reconstruct the pre-war pattern of trade, with Europe selling capital equipment and manufactures to countries other than North America, like Malaya and Australia, which in return would produce raw materials which the Americans wanted, like rubber and wool. To do so the Americans would have to continue foreign aid and lending programmes, and to direct aid to underdeveloped primary producing countries so as to develop production there. The Australians also wanted to challenge the American ‘misconception’ that Australia was a burden on the United Kingdom and a contributor to that country’s dollar crisis. They argued that the growth in Australia’s sterling balances was mainly due to unmatched exports to Europe and only partly due to an outflow of capital from Britain. 47

The American solution to the dollar problem adumbrated in the IMF draft report threw the Chifley government into gloom. Chifley thought that, as with the Anglo-American loan agreement of 1945, the Americans were throwing the burden of achieving international equilibrium onto debtor countries in the sterling area and western Europe. A plan based simply on the idea of lowering costs of production and raising productivity in western Europe was, in Chifley’s view, an inadequate solution. If the Americans continued to ignore the sterling area in their plans for the reconstruction of the world economy, instead of lending more to and purchasing more from sterling area countries, the problem of the dollar shortage would remain unresolved and Australia would continue to be threatened by depression at the slightest

47 ‘Fund draft report’, draft telegram from Watt to Wilson, n.d. CP 286/3/1 Bun6/1533 Part 1, AA.
downturn in American economic activity. International economic collaboration was in danger of failing and it was still possible that Australia might be forced to participate in a non-dollar autarky. In these circumstances, the government was determined to limit dollar expenditure, particularly on petroleum.

The Labor government had continued to ration petrol in varying degrees after the war, under the defence power. On 25 May 1949 Chifley explained that although the world supply of petrol was ample, the foreign exchange prevented Australia from obtaining enough petrol to satisfy demand. He argued that the production of petroleum products from British controlled sources was still not sufficient to satisfy the needs of the sterling area and to maintain exports to foreign countries. These exports had to be kept up in order to save the dollar pool gold and dollars and to assist in the rehabilitation of western Europe. Accordingly it was necessary to continue the rationing of petrol in Australia.\footnote{Statement of J.B. Chifley PM, 25 May 1949, CRS A571 39/3115 Part 1, AA.}

On 6 June 1949 the full high court unanimously declared the national security (liquid fuel) regulations, under which petrol rationing operated, invalid. This successful challenge by two petrol retailers to the Commonwealth's control of rationing, was an even greater blow to the Chifley government than the high court's invalidation of bank nationalisation in 1948. The Commonwealth government had been unable to obtain direct constitutional power to ration goods and was therefore relying on the defence power to justify the retention of petrol rationing.

In February 1949 the department of postwar reconstruction had argued that it was not possible to establish a direct link between the liquid fuel regulations and the defence power on the grounds either of a world supply shortage or the necessity to preserve reserve stocks. There was no world shortage of fuel and if the Commonwealth wished to hold reserve stocks it could purchase supplies independently of the regulations. The department thought that it would be difficult to convince the
high court that motor-spirit rationing could not be done by the states. The only argument against control by the states was that certain and uniform control was essential and that the level of rationing should be immediately controllable by the government which had the task of dollar budgeting.

Postwar reconstruction suggested an argument in the high court containing four main points: that the dollar shortage in the sterling area was due to the war; that the sterling area was in a transitional period which, given favourable conditions, might end in 1952; that until then imports from the dollar area had to be confined to essential goods; and that the gentleman’s agreement between Australia and the United Kingdom gave Australia sterling–dollar convertibility privileges only if the Australian government maintained import controls comparable with the United Kingdom’s. So far the argument extended to the necessity of the Commonwealth government restricting petroleum imports. The next step in the argument was to say that if the Commonwealth government could not control rationing, this would result in a glaring breach of the gentleman’s agreement, and a hindrance to the sterling area’s economic recovery. The argument, in brief, was that petrol rationing was an essential adjunct to import control, which was in turn essential for recovery from the disruptions of war.

The high court’s judgement was that the liquid fuel regulations dealt only with the distribution and disposition of fuel after it had been imported into Australia. They did not profess to deal with the amount of petrol imported into Australia. While rationing might reduce consumption of petrol and thus lessen the need for a greater quantity of petroleum imports, the high court was not convinced that this had any connection with the defence power.

The high court did not demand the cessation of all laws under the defence power immediately hostilities ceased. It allowed the Commonwealth to legislate in peacetime for problems obviously created by the war – such as the rehabilitation of soldiers and the rebuilding of cities. Moreover it agreed that the very fact that controls or regulations already established might create a situation which had to be maintained for a reasonable time while some other legislative provision was made. But it applied the general rule that the 'court must see with reasonable clearness how it is incidental to the defence power to prolong the operation of a war measure dealing with a subject falling within the exclusive province of the states and unless it can do so it is the duty of the court to pronounce the enactment beyond the legislative power.'

At the London finance ministers' conference in July, the British minister for fuel and power, Hugh Gaitskell, confirmed the need to continue petrol rationing in the sterling area. Dedman explained to him the difficulty which the Australian government would have in rationing petrol after the high court's decision, and predicted that the government would have severe difficulties if, at the end of a given period, and in the absence of any rationing scheme of the state governments, it found that no more petrol was left.

Dedman was right in predicting that the task of convincing the states to agree to petrol rationing would be a hard one. In the interval between the high court's rejection of petrol rationing in June and an agreement between Commonwealth and states, Chifley was relying on the oil companies to control distribution. At a conference of Commonwealth and state ministers in August the liberal premier of Victoria, T. Hollway, tried to suggest that there was no need for the reintroduction of petrol rationing since the increase in petrol consumption in June was entirely due to the coal.

51 Oil discussions, Commonwealth finance ministers' conference London, 14 July 1949, CP 286/2/1 5222, AA.
strike. Chifley refuted this argument by producing figures showing that the extra consumption of fuel owing to the strike was 5,230,000 gallons, whereas the total extra consumption above the amount that would have been available had rationing been continued, was 21,000,000 gallons. Chifley reported that the oil companies had made a gentleman’s agreement with the Commonwealth to try to draw from bond only the quantities that they would have drawn under petrol rationing. But the oil companies had no control over the way petrol was distributed once it went out of their centres. He was adamant that he could not offset the increase in this additional consumption, because he could not draw on the sterling area reserves for more dollars. Indeed he advised the premiers that the situation might worsen in the near future: Australia might be forced to live on the dollars which she earned, because she would be unable to earn them from the British treasury. The president of the Liberal party privately supported Chifley’s arguments. He wrote to Page on 14 July that ‘I am quite convinced that we cannot get more petrol in Australia without further eating into the Empire dollar pool. I have kept in touch with the chairmen of the two biggest oil companies in this regard over the last 12 months, and my definite information from them is as I have said’.

The premiers then proceeded to argue the merits of different rationing systems. The premier of Queensland, E.J. Hanlon, argued that the rationing of petrol by uniform state legislation might prove inequitable. Motorists in New South Wales, for example, might exhaust the quota of petrol allocated to Queensland. Hanlon suggested that the Commonwealth still had the power to buy all the petrol imported into Australia and to distribute the supplies itself. Attorney–general Evatt replied that this could

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52 Conference of Commonwealth and state ministers held at Canberra, 16 and 17 August 1949, pp.7–8, CRS A571/1 49/1389, AA.
53 Ibid., p.8.
54 Ibid., p.9.
55 Ibid.
56 Casey to Page, 14 July 1949, Page Papers, MS 1633, folder 880, NLA.
57 Conference of Commonwealth and state ministers held at Canberra, 16 and 17 August 1949, p11. CRS A571/1 49/1389 AA.
only be done if the Commonwealth set up a system of distribution to rival the oil companies. For the Commonwealth could not compel a retailer to become an agent for distribution. He added that the Commonwealth could have the necessary power over the distribution of petrol supplies if the states delegated the Commonwealth the necessary power. The Liberal premier of Victoria baulked at this suggestion, fearing that the Commonwealth would thereby gain a permanent accretion of power over the states. He suggested that the Commonwealth should seek a dollar loan to purchase the additional petrol. Chifley replied that no international lending organisation would entertain the notion of lending dollars to Australia so that farmers in Western Australia could carry tomatoes by lorry to Victoria. He ended the discussion with a warning that conservation of dollars was essential for the preservation of the sterling area and that if the sterling area collapsed, Australia would be in an even worse position.58

The *Age* newspaper in Melbourne was entirely convinced of the necessity for petrol rationing. It noted that ‘instead of an increase of five or ten per cent in consumption after rationing ended – as estimated by some people – the figures showed increases which, if continued, would amount to about twenty-five per cent above the quota’. Because the excess consumption in the period since the cessation of petrol rationing could not be imported, and had to be saved over the next ten months, there were obvious risks of a petrol famine unless consumer rationing was promptly returned.59 The *Age*’s approval of the Chifley government’s dollar policy was in marked contrast to the *Sydney Morning Herald’s* general disapproval. The *Herald’s* attitude was that the government’s trade policy involved shutting out a great deal of essential supplies and equipment which were badly needed for Australia’s development:

No account seems to have been taken of the wide possibilities of finding dollars for long-range development without drawing on the Empire dollar pool. Australia’s credit standing is sound, and a request for a long term dollar loan, whether from the open market or through some governmental

59 *Age*, 17 August 1949.
agency, should meet with a good response. Even without going to this length the Commonwealth might, by adopting a more sympathetic and encouraging attitude, stimulate the flow of American private capital seeking direct investment in Australian industry. Besides promoting a greater industrial diversity, of value in itself, American investment would increase our exporting capacity, and so in the end help to ease our dollar problem.  

The plan to reintroduce petrol rationing by the states referring power to the Commonwealth was blocked in Victoria. The cabinet there decided that it would not reintroduce petrol rationing in Victoria if it had to be done by reference of state powers to the Commonwealth. But an influential minority of the Victorian government believed that rationing had to be reintroduced in order to safeguard distribution of petrol supplies and to help preserve Empire dollar reserves. Menzies strengthened the Victorian government in its determination to resist the Commonwealth government when he addressed his state colleagues on 29 August telling them that 'Mr Chifley has passed the onus [of reintroducing rationing] onto the states in an obvious underground move to embarrass the states and to help him to win the federal election'.

Menzies himself led an opposition censure motion of the government on the petrol issue on 14 September. He placed the blame for the inadequacy of petrol supplies on the Commonwealth government not importing enough petrol, rather than on the constitutional difficulties preventing the Commonwealth from rationing petrol. He castigated the government for not seeking a referendum on rationing, if it knew that there would soon have been inadequate supplies from overseas. Menzies made the general point that the Labor government’s approach to the dollar problem was negative. 'It is clear', he argued, 'that if the solution to the petrol problem is dollars,

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60 SMH, 12 October 1948.
61 Age, 23 August 1949.
62 Age, 30 August 1949.
then we should devote a whole lot more importance on earning dollars, and a great deal less attention and anxiety to the mere restriction of the use of dollars'. 63

In answering Menzies, Chifley displayed a complete mastery of his case. He argued that 'the primary difficulty in respect of obtaining petrol supplies arises, not from the Commonwealth's power to curtail its importation, but from the inability of the whole sterling area to obtain dollars to pay for additional supplies'. He poured scorn on Menzies' idea that an Australian production drive would provide an answer to the dollar problem. If such a drive was practicable, why was it that in only a few of the last twenty years Australia managed to earn more dollars than she spent. He challenged opposition claims that petrol was available from non-dollar sources of supply. As he had told the premiers, the states must either ration petrol themselves or allow the Commonwealth to do it. 64 Evatt supported the prime minister in a fighting speech. He argued that there were two courses open to Australia. The first was to stick with the sterling area, and continue to conserve dollars in return for being supplied with dollars from the British treasury. The second was to abolish petrol rationing, renege on the gentleman's agreement with the other members of the sterling area, and thus repudiate the sterling area. 65

While the Victorian government was debating the advisability of restoring petrol rationing, it was becoming increasingly doubtful that a system of rationing by the oil companies would prove workable. New South Wales, Queensland, and Western Australia had delegated power to the Commonwealth to ration petrol five years previously. South Australia followed suit in September 1949. And shortly afterwards the federal opposition caved in. Menzies, while still placing the blame for the

64 Ibid., pp.195–203.
65 Ibid., pp.237–42.
inadequacy of petrol supplies on the Commonwealth government, affirmed that he agreed with South Australia and that Victoria and Tasmania should follow its lead. 66

The Victorian government finally buckled under on 13 September. Premier Hollway wrote to Chifley that if the Commonwealth parliament passed legislation governing the distribution of petrol in the federal territories, New South Wales, Queensland, and Western Australia, he would submit to the Victorian parliament a bill to implement petrol rationing on the same basis as that proposed by the Commonwealth. He subsequently introduced this bill on 21 September.67 In the second reading debate on the Victorian liquid fuel bill, Labor members pointed out that the oil companies had not cooperated with the Commonwealth to preserve petrol, but had recklessly advertised a commodity which they knew would be in short supply. The delay in the reintroduction of petrol rationing, the squabbling of the premiers, and the obvious recklessness of the oil companies led to a situation which was described by the Age on 5 October:

At no time in the past, even when allowances were cut to their lowest levels during the grimmest stages of the war, was there such difficulty in obtaining petrol, so many pointers to private hoarding, and such obvious maldistribution, with inevitable risks of price squeezes, rackets, and favouritism on an expanding scale.68

Although the federal opposition had acquiesced in the states referring power over rationing to the Commonwealth, it kept up its opposition to the reintroduction of rationing by suggesting that the government could obtain large amounts of non-dollar petrol – in particular from Poland, Russia, and France.69 A government memorandum of 17 October set out the position on petrol supplies fully. The cost of producing and purchasing petroleum was the largest single item in the sterling area’s dollar deficit. Because of limitations on refinery capacity, the British controlled oil companies could

66 Statement of Messrs Menzies and Fadden, 9 September 1949, Dedman Papers, MS 987 Series 14 items 739–40.
68 Age, 5 October 1949.
not produce enough petroleum to meet the needs of the sterling area. So the sterling area had to pay out large amounts of dollars to purchase petrol from American companies. And even purchases from British controlled companies had a large dollar component. For these companies operated in many different parts of the world and incurred dollar expenditure on their operating costs, royalty payments, and essential plant and capital equipment.

The government considered that all the opposition claims of significant non-dollar sources of petrol being available were red herrings. The Polish government had indicated that there was no surplus of Polish petrol for export, and despite the Commonwealth government’s willingness to issue import licences, no Russian petrol was available. One shipment from France had been licensed but its quantity was not sufficient to change the general position of the supply of petrol. Although imports of petrol had been designed to meet the rationed scale plus a special allowance for the coal strike, the oil companies had been oversold by twenty per cent of this figure in June, July, and August. As a result, petrol stocks were at a very low level, and were in danger of falling below the minimum safe level recommended by the defence committee. The situation was that unless rationing was introduced, the petrol position could only be remedied by importing more petrol or releasing the security stocks. The first alternative was impossible if the government was to stick by its decision to abide by the collective decisions of the Commonwealth finance conference; and the second would prejudice Australia’s security, especially since the government had no constitutional power to ensure the equitable distribution of the security stocks, and no way of guaranteeing that the security stocks could be replaced from dollar sources.70

The Chifley government finally was able to bring in a bill for the reintroduction of petrol rationing in late October. Typical of the opposition’s criticism of the liquid fuel rationing bill was Percy Spender’s speech to the house of representatives on 26 October. Spender criticized the prime minister for not attempting to obtain dollars by

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70 'Petrol supplies and distribution', 17 October 1949, CRS A571/1 39/3115 Part 2, AA.
loans from the United States or from getting dollars as a quid pro quo for Australia’s assistance in western Europe’s economic reconstruction. He declared the government totally subservient to the British: ‘apparently the position is that Australia is unable to get dollars according to the extent to which Britain is unable to get dollars...’ 71 Chifley replied that there was a limit to the sources from which Australia could obtain dollars. The only sources from which Australia could get dollars were international agencies like the IMF and the IBRD, private institutions in the United States, and the Empire dollar pool. To get dollars from the international agencies was immensely difficult, borrowing outside these agencies would result in Australia paying exorbitant rates of interest, and the United Kingdom’s reserves could not be drained any further. The high court’s invalidation of petrol rationing was a ‘national calamity’ which could only be remedied by the present bill. 72

Meanwhile in the United Kingdom there was a change in thinking about how to deal with the dollar crisis. Younger ministers like Hugh Gaitskell, Herbert Morrison, and Harold Wilson wrested the control of economic policy from Cripps’s ailing hands. Cripps was opposed to devaluation of sterling, arguing that the political and economic costs of more expensive imports into Great Britain offset any possible advantage gained by increased sterling area exports to the dollar area. For Cripps the four dollar pound was the ark of the covenant. The younger ministers seized on the currency crisis to urge the devaluation of sterling as a first step in a larger programme that would cut social expenditure, dismantle economic controls, and bring Great Britain and the dominions into a multilateral system of world trade. Despite Cripps’s last ditch opposition, the announcement of these measures was set for 18 September.73

With British economic policy on a new course, the British cabinet briefed their negotiators for the discussions with the Americans and the Canadians in Washington in

72 Ibid., p.2098.
73 Hogan, op. cit., p.249.
September. Before the Commonwealth finance ministers’ conference American treasury secretary, John Snyder, engaged in discussions with the British and Canadians in London. The only positive thing to come out of these July talks was the decision to continue the talks in Washington in September. Britain’s negotiators, Bevin and Cripps, left London with the solemn pronouncement that they had embarked on ‘one of the most important missions in history.’ The talks would determine whether multilateralism succeeded, whether depression was avoided, and whether the economic system established at Bretton Woods survived. Cripps and Bevin were briefed to deny that British social expenditure had contributed to the dollar crisis, or that inflationary pressures were driving the United Kingdom government to shelter within a high cost soft currency trading bloc. They were to emphasise instead their government’s commitment to a one–world trading system and the contributions it was making towards the attainment of that goal.

The Washington economic discussions began on 7 September. When Cripps and Bevin announced the British plans to devalue sterling, cut costs, control inflation, and redirect exports to the dollar area, the Americans responded with a large number of reciprocal concessions. The Americans announced that they were ready to expand the list of British imports eligible for assistance under the Marshall Plan, to review their stockpiling programme with a view to stepping up purchases from the sterling area, to permit a higher volume of rubber and tin imports, to simplify customs procedures and to negotiate tariff reductions under the reciprocal trade agreements act. They were also willing to encourage private investment in the sterling area, to urge the International Bank to initiate development projects there, and to establish a continuing consultative body to investigate ways of handling the accumulated sterling balances in London and of limiting Britain’s dollar expenditure on shipping and oil transactions.75

75 Hogan, op. cit., pp.252–3; communique issued in Washington at the close of the talks between the United Kingdom, the United States, and Canada, on the dollar situation, CRS A571/2 49/2396; telegram
On 18 September the British government announced a very heavy devaluation of sterling in terms of the dollar. The pound sterling, instead of being worth $4.03 was to be worth $2.50, a devaluation of over thirty per cent. The Australian pound, before depreciation, was worth 75 per cent of the British pound. After discussing the matter with his closest economic and political advisers, and without the further consultation of cabinet, Chifley decided to follow the British. He told parliament on 20 September that there were three choices open to the Australian government: to maintain the existing relationship with the dollar and appreciate against sterling; to maintain the existing relationship with sterling and depreciate against the dollar; or to adopt a middle course involving some appreciation against sterling together with some depreciation against the dollar. In Washington McFarlane told the IMF that if Australia did not depreciate by the full thirty per cent, she would suffer a fundamental disequilibrium in her balance of payments. The idea that Australia would shortly suffer an economic downturn was the premise of his argument:

We had enjoyed the benefits of unprecedentedly high prices and good seasons for two years, and were now in a period of readjustment. Appreciation [against sterling] would involve a big loss of income which, associated with rising costs, would bring disturbances and create a fundamental disequilibrium.

The American assistant secretary of state, Frank Southard, was unhappy with this position, thinking that Australia should make her pound worth $2.80 rather than $2.24, but eventually acquiesced in the Australian request.

Chifley explained that the decision to devalue by the full thirty per cent meant that there would be no change in the exchange basis of Australia’s trading relationship with her most important trading partner – the United Kingdom. Depreciating against the dollar would raise the price of North American goods and thus fuel inflation in

from the secretary of state for Commonwealth relations to the Australian government, 13 September 1949, CRS A1838/TS8 67/3/2 AA.


77 McFarlane to Chifley, 19 September 1949, CRS A571/2 65/324 Part 1, AA.
Australia. But although the goods imported from the United States were important to the Australian economy, they did not represent as high a proportion as Britain’s share of Australia’s total imports. The United Kingdom supplied Australia with about half her imports and took 43 per cent of Australia’s exports. The Australian economy was moreover dependent on a few major exports. Wool and wheat together accounted for 62 per cent of them. And in the government’s view Australia’s £452 million sterling balances were barely adequate. They were largely held in inconvertible sterling and as much as £150 million represented temporary investments. Chifley wanted to build up Australia’s London funds even further, not to run them down. The government concluded that any appreciation against sterling would reduce British purchases of Australian exports, reduce Australian prices and incomes, and increase Australian imports of British goods. Although this would have brought down inflation, Chifley’s cabinet was more worried about the predicted depression than about the upward movement of Australian prices and incomes.78

Chifley and his advisers were aware of the popular theory that import restrictions were the wrong approach to Australia’s dollar difficulties and that the right line was export development and dollar loans. But they had in mind the fear that Australia’s dollar situation might get even worse, and that Australia’s borrowing capacity should be reserved. Moreover the government had to consider the consequences of British retaliation if the two currencies did not move together. The British could withdraw imperial preferences on Australian goods, cease making long term contracts for Australian primary products, and impose controls on the transfer of British capital to Australia since it would require a greater quantity of British pounds to buy the same volume of Australian assets.79 A number of considerations determined Chifley’s policy: that Australia’s long term interests lay with the United Kingdom and the sterling area rather than the United States; that the need of the sterling area as a

78 ‘Proposed exchange adjustment – Australian pound’, n.d. CRS A571/2 65/324 Part 1 AA.
whole to earn more dollars was greater than Australia’s individual need to be able to borrow dollars cheaply, as it would if the Australian pound were not depreciated; and that Australia had more to fear from depression than it did from inflation, which would only be a temporary problem. 80

The government’s prompt devaluation of the Australian pound provided some good ammunition for the Liberal party. Menzies devoted much of his budget speech to the issue. The *Sydney Morning Herald* thought that this was one of the best speeches of his career, although coalition disunity blunted the impact of his argument. 81 The Country party supported devaluation as a means of protecting the export trade of the rural sector. The Liberal party, on the other hand, wanted some measure of appreciation against the pound sterling in order to increase the purchasing power of the Australian pound, to curb inflation, and to make dollar borrowing easier. Menzies argued that the United Kingdom’s devaluation was excessive. In his view devaluation would not help to solve the dollar problem unless British exports to the dollar area increased by 150 per cent. Moreover a redirection of British exports to the American market would mean less British goods for Australia. Devaluation of Australia’s pound by the full thirty per cent would increase Australia’s overseas income and thus the inflationary pressure on the whole of the Australian price level.

To ‘put value back into the pound’ became a catchcry of the opposition in the 1949 election. Inflation had been eating away the value of the Australian pound at a rate of about ten per cent per year in 1948 and 1949. And now the British and Australian ‘socialists’ had reduced the value of the pound even further by a massive devaluation. If the Chifley government had taken the opportunity to appreciate against sterling, Menzies intimated, it would have restored some value to the Australian pound by making imports cheaper and curbing inflation. But the main cure for Australia’s economic ills – a weak currency, inflation, and shortages – was vastly increased

81 *SMH*, 22 September 1949.
production. Australian workers needed to be more productive and strikes had to be curbed. For him 'the consequence of these achievements would be a reduction in the unit cost of articles and a rise in real wages through falling prices'.

The 1949 Election

The defeat of the Chifley government was a consequence of a combination of factors: the failure of its domestic economic policy to control inflation; the occurrence of a general coal strike which it had gone to great lengths to prevent; the disastrous dollar crisis of 1949; fear of communism and war in the Australian community; and the government's attempted nationalisation of the private trading banks. The government's attempted nationalisation of the banks in 1947 began a swing against Labor but it was not the decisive cause of Chifley's defeat. Opinion polls taken in July 1947, before nationalisation, indicated healthy support for Labor. But an opinion poll taken in September 1947, after the government's announcement of nationalisation, suggested that Chifley would have been lucky to survive a challenge from the opposition. And an opinion poll taken in February 1948 showed that the coalition parties were maintaining a lead over Labor of 50 to 46 per cent. It was not until the high court removed the issue from the political arena by declaring bank nationalisation invalid, that the government began to recover in the eyes of the public. By February 1949 the government's fortunes had revived, and an opinion poll taken in that month indicated majority support for the Chifley government. The propaganda campaign against the Labor government in the election campaign organised by the private banks was clearly of some importance in affecting the attitudes of voters. The role of the banks in Chifley's election defeat has been assessed by, among others, L.F. Crisp and A.L. May.

I have omitted an extensive discussion of the propaganda campaign of the banks

82 CPD, Vol. 204, 21 September 1949, pp.429–33.
83 Australian Gallup Polls (AGP), July–August 1947.
84 AGP, February–March 1948.
85 AGP, February–March 1949.
because that aspect of the 1949 election has been adequately dealt with by others and because the central concern of this thesis is with the fundamental attitudes taken by government and opposition to long term problems: differing assessments of the threat to Australia of depression and war, changing policies towards sterling area protectionism and multilateralism, and the dispute over whether Australian foreign policy should be internationalist or anti-communist.

Equally as important as the swing in the popular mood against 'socialism' was the growing fear of war and of communism in the Australian community. Opinion polls indicated that in September 1947, Australians were not worried about the prospect of another war. Only 38 per cent of those polled in Australia as compared with 53 per cent in the United States thought that war would break out before 1957. 87 But polls taken in March 1948 showed that 61 per cent of Australians believed that the Soviet Union was an aggressive nation with hostile intentions to the rest of the world. 88 This fear of the danger of war from communist aggression added to the distaste of Australians for domestic communism. Polls taken in March 1948 indicated that eight out of every ten Australians interviewed thought that it was necessary to ban the Australian Communist party and to remove communists from high positions in trade unions. 89 After the Berlin dispute anti-communist opinion hardened. Seventy-five out of every hundred Australians interviewed in September 1948 thought that the Soviet Union was determined on a path of aggression, and 54 per cent said that if the Berlin dispute were to escalate into a full scale war, Australians should fight alongside American and British troops. 90 A poll taken at the end of 1948 pointed to a remarkable turnabout in public opinion. Whereas in August 1947, only 38 per cent of Australians feared the outbreak of war within ten years, at the end of 1948, 67 per cent

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87 AGP, September 1947.
88 AGP, March–April 1948.
89 Ibid.
90 AGP, August–September 1948.
of Australians did. Australia became the nation most fearful of the outbreak of war, surpassing even the United States. 91

Opinion polls of February 1949 showed Labor with 50 per cent support and the Liberal and Country parties with 47 per cent. 92 Polls published in April 1949 continued to indicate that the federal election due to be held at the end of the year would be close. The polls showed that ‘socialism’ and ‘communism’ were the most significant factors in the minds of swinging voters. 93 The federal election still looked like being an even contest at the commencement of the coal strike In June, but polls also suggested that there was much disenchantment with public controls. Two out of every three Australians polled indicated their wish for an end to all forms of public rationing, including the rationing of petrol. 94

What tipped the balance against the Labor government was the coal strike and the 1949 dollar crisis. The economic cost of the strike to Australia, as estimated by the Age on 12 August was a loss of 2,000,000 tons of coal. It caused a loss of £33 million in wages not paid to workers and £100 million goods not produced. At its peak, unemployment totalled 630,000 and relief payments about £1,250,000. 136,000 fewer tons of pig iron were produced, 170,000 fewer tons of steel, 27,000 fewer tons of steel, 27,000 fewer houses, four million less bricks, 5,500 less stoves, and 6,750 less refrigerators. With a national income of about £2000 million the strike caused Australia a loss of about five per cent of its national income. Such a massive loss gave credibility to Menzies’ urging of the need to increase Australian production. 95

The opposition’s criticism of Chifley’s handling of the strike was summarized by Menzies during a debate on a bill to grant Commonwealth funds to the states in order to cover their costs incurred in the coal strike. Menzies censured the government for

91 AGP, October–November 1948.
92 AGP, February–March 1949.
93 AGP, April 1949.
95 Age, 12 August 1949.
three mistakes: the inadequacy of its measures to build up coal reserves before the strike; its refusal to break the miners’ monopoly by allowing the Australian Workers’ Union to mine the open cuts; and the government’s general failure to institute firmer measures against the Communist party and communist inspired strikes. Menzies’ argument was that the strike was political not industrial. The communist leaders of the miners were concerned to seek Australia’s industrial destruction ‘in order to weaken the Australian economy at a time of crisis and to prevent preparedness for war’. The argument had been used by the Labor government during the strike and was now being thrown back at it with great relish. Menzies’ conclusion was that the government elected in December would have to strike at the Australian Communist party.

The dollar crisis also worked to the detriment of the incumbent government. Menzies made three key points about petrol in his campaign speech: that the British and Australian socialists had failed dismally to encourage an increase in sterling area refinery capacity; that some European countries had managed to abolish petrol rationing; and that the Chifley government had made no effort to obtain a sound constitutional basis for petrol rationing. Menzies promised that the Liberal party would get petrol in adequate supplies and even that ‘as an interim measure and under proper safeguards, it would be prepared to draw on our [defence] reserves now held in Australia.’ Arthur Fadden went even further on 17 November when he pledged the Country party to ‘free Australia from petrol restrictions as early as possible in the new year.’ Spender later told the British that he ‘recognised that the policy [of the

97 Ibid., p.1528.
98 Argus, 11 November 1949.
99 Ibid.
100 Melbourne Herald, 18 November 1949.
coalition on petrol] was in itself wrong, but Mr Fadden had made it the main plank of his election speech.' 101

Petrol rationing was the last straw for the Chifley government. As Fadden later recorded in his memoirs, 'I am inclined to think...that petrol rationing was the rock in the stormy seas on which the government finally foundered'. 102 If the high court had not invalidated rationing by the Commonwealth, petrol would not have emerged as the burning issue it was to become. But in the interval between the high court’s judgement in June and the reintroduction of rationing in November, the orderly distribution of restricted petrol supplies was disrupted. The disorder in petrol distribution became a popular grievance. And when the opposition told the public that rationing itself was unnecessary, it became even more of a grievance. Opinion polls taken after the election recorded that of the eight per cent of voters who voted Labor in 1946, but voted non–Labor in 1949, six out of every ten considered petrol rationing when casting their votes. 103

Menzies launched his campaign in Melbourne on 10 November. The first part of his speech was a critique of socialism. He attacked socialism for creating an illusion of prosperity, reducing living standards, creating dependence on the government, weakening the British empire and fostering atheism. Labor had become a government of socialization not reform.

Menzies argued that the Commonwealth ought to have the power to declare certain strikes illegal, and that the rules of unions should contain ‘provisions for the election of officers and the taking of major decisions involving stoppages, by secret ballot’. Furthermore, declared Menzies, the Communist party would be declared unlawful and ‘subject to appeal, the attorney–general would be empowered to declare

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101 Record of conversation between Percy Spender, minister for external affairs and the secretary of state for Commonwealth relations, 11 January 1950, PRO, DO 121–182 confidential print 6014, joint copying project NLA.
102 Fadden, op. cit., p.101.
103 AGP, November–December 1949.
other bodies substantially communist and to follow the party into any new form and to attach illegality to that new association’. Individual communists would be debarred from holding government positions or from holding offices in registered industrial organisations. He then turned to a subject closely linked with communism in the popular mind – coal. He promised rapid development of open cut mining, the building up of coal reserves, and the restoration of the coal industry to the jurisdiction of the arbitration court. Menzies also promised to raise dollar loans for developmental purposes, restore the bank board as the governing body of the Commonwealth bank, introduce child endowment for the first child in every family, and introduce compulsory military training. 104

The Age described Menzies’ election speech as an ‘impressive, even masterly survey of the scene from the opposition standpoint’. Menzies had made socialism the dominant issue and ‘if the Labor party wants to convince the country that the issue delineated by Menzies does not really exist it will have to state clearly what, if any, further nationalising ventures are to be made and – equally important – what areas of industry or service will not be disturbed.’ 105 But there was in fact no question of the Labor government intending to implement a comprehensive programme of socialization. Bank nationalisation was an aberration. And the opposition was able to convince the public that it was evidence of a much wider socialist intent than was ever envisaged by the Labor government. They conflated bank nationalisation, undertaken for what might legitimately be called ‘socialist’ principles, with the Chifley government’s retention of postwar controls in the interests of maintaining the economic stability of both Australia and the sterling area, into a comprehensive ‘socialist’ plan. The core of Labor’s policy under Chifley was not a theoretical antipathy to private monopolies and private enterprise, but a practical readiness to take whatever steps were necessary to avoid another depression. Chifley’s was a collectivist

104 SMH, 11 November 1949.
105 Age, 11 November 1949.
rather than a socialist government. This collectivism embraced the control of economic and social processes sufficiently to maintain full employment and the provision of Commonwealth aid, direction, and initiative, over national development. 106

Chifley’s policy speech, delivered on 14 November, contained no glittering promises. The Labor government stood on its record. His opponents, Chifley declared, would ‘raise bogeys and whip up side issues’ about communism and socialism but the government would simply ‘treat all this with the contempt it deserves’. The maintenance of full employment was the government’s main achievement. But full employment could only be preserved if positive measures were taken to ward off depressions and to ensure that, as the economy grew, there would still be jobs for those seeking them. Circumstances could easily change in an economy linked with many other countries through overseas trade. Chifley laid great stress on the measures the government had taken to buttress Australia’s position against adversity abroad. It had built up international reserves to £450 million, reduced government debt, negotiated long term contracts for primary products, kept interest rates low, and created large reserves of public constructional works.

Chifley admitted that coal production remained a serious problem. He said that even if 1949 had been completely free from strikes, production would still have fallen 1,000,000 tons short of requirements. With industrial problems causing losses of about 2,000,000 tons per year, coal production needed to be lifted 50 per cent within five years. This would be done by increasing the mechanization of mines, and increasing the number of open cuts. Chifley failed to match Menzies’ promise of providing child endowment for the first child in every family, mainly because the arbitration court was considering a basic wage application from the trade unions. 107

107 Argus, 16 November 1949.
The crux of Labor's 1949 campaign was the assertion that the government was making security against depression its dominant policy. Chifley did not see inflation as the main threat, although admittedly it was a problem, because he thought that an economic downturn would follow hard on the current period of inflation. He did not think that Australia had to fear anything from the outbreak of war. This was in direct contrast to Menzies. In promising to 'put value back into the pound' Menzies was fighting inflation first without fear of a subsequent depression. Simultaneously he was promising to step up Australia's defence preparations against the threat of war and to speed up the pace of Australia's development. Furthermore it seemed logical to Menzies that banning the Communist party and getting rid of communists from trade unions would increase production and also prevent the Australian Communist party from hindering war preparations.

An Age editorial of 15 November observed that the 'head and fount of Labor policy is to maintain full employment by an application of Keynesian techniques'. The only difference between government and opposition here, the paper argued, was that Labor ascribed more importance to monetary management and public works in maintaining full employment, while non-Labor emphasised increased production and the prosperity of private enterprise. The Age agreed with Chifley that cuts in government expenditure and tax relief – the long term aim of the coalition – would be difficult to achieve.

The heaviest outlays, as Mr Chifley pointed out, are the kinds that no political party would be disposed to reduce or abolish such as war and postal charges, debt liabilities, subsidies, state payments, capital works and social services.

The opposition had in fact promised increases in social service payments, compulsory military training, price subsidies, subsidized imports of petrol and coal, and a new ministry of development, all of which sat oddly with a policy of tax relief. The
government's fiscal programme in the campaign was much more conservative than its opponent's. 108

Shortly after Fadden had made his policy speech for the Country party, in which he promised both the abolition of petrol rationing and the reintroduction of compulsory military training, Chifley launched a counter attack. The government would have nothing to do with compulsory military training except in a period of emergency. If the aim was to increase production, it was essential to employ as much labour as possible in civilian production. He also attacked the idea of restoring the Commonwealth bank board as putting the control of Australia's economy in the hands of private financial interests. And finally he dismissed the policy of banning the Communist party as a futile measure. 109 Ministers like Dedman and Calwell, the minister for immigration, vigorously attacked compulsory military training. Calwell argued: 'there is no war imminent and the military advisers of the Commonwealth have not advised such a course'. 110 The accusation that compulsory military training would severely dislocate the economic life of the country began to cause the coalition some concern. Menzies wrote on 27 November that, 'the government is attempting to create an impression that, should the opposition win the election, there would be an immediate disorganisation of all normal activity by the introduction of compulsory military training.' To defuse the situation he proposed that the opposition should indicate that they would put the issue to the people at a referendum shortly after being elected. Holt advised against this action. 111 So instead Menzies began stressing that universal military service would be introduced gradually and with due regard to its effects on the economy.

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108 *Age*, 16 November 1949.
109 *SMH*, 16 November 1949.
110 *Age*, 12 November 1949.
111 'Defence policy', 27 November 1949, Menzies Papers, MS 4936, Series 19, Box 439, folder 1, NLA.
At the election on 10 December, Labor was decisively defeated. Its percentage of the primary vote dropped from 49.71 per cent in 1946 to 45.96 per cent. The anti-Labor vote increased from 43.65 per cent in 1946 to 50.26 per cent in 1949. In the house of representatives, which had been enlarged from 74 to 121 members, Labor won 47 seats and the coalition parties 74. 112

The election result varied from state to state. In New South Wales, the coalition picked up more of the newly created seats than Labor, but overall won only one more seat than Labor did. 113 In Victoria the results were similar. The coalition had four more seats than Labor in the old house and increased this to seven in the new house. Labor lost Ballarat, Wannon, and Corio, Dedman’s seat, to the Liberals, but won Bourke from an independent, Fawkner from the Liberals, and Bendigo from the Country party. 114 In Queensland Labor suffered a landslide defeat. Whereas Labor gained five of the ten Queensland seats in the old house, it could only manage three of the eighteen seats in the expanded house of representatives. The Liberals won all the new Brisbane seats – Bowman, Oxley, Petrie, and Ryan – and the Country party won the new seats of Dawson, Fisher, Leichhardt, and McPherson. Considered on a state by state basis, roughly half of Menzies’ twenty-seven seat majority came from Queensland. Labor’s two seat majority in South Australia was converted into a two seat deficit, its one seat majority in Tasmania into a three seat deficit, and a three seat majority in Western Australia into a two seat deficit.

Conclusion


114 Ibid., Of the new seats, Labor won Darebin, Gellibrand, Hoddle, Lalor, and Wills; the Liberals won Chisolm, Higgins, Higginbotham, Isaacs, Latrobe, and McMillan; and the Country party won Mallee and Murray.
Labor's downfall in 1949 can be explained in terms of my broad thesis: that Labor's overriding concern with the economic security of Australia and the sterling area was no longer the main worry of Australians. They were beginning to respond to the opposition's specific criticisms of the problem of inflation and shortages - which Labor might be said to have dealt with inadequately - and its more general concern with fear of communism and war.

The Chifley government's view was that depression was likely because the process of international economic reconstruction had gone awry. In 1945 the Americans had tried to impose multilateralism on the British Commonwealth before equilibrium had been restored to world trade. When they finally decided to treat the dollar problem in 1947, they adopted a plan which, because it focussed solely on restoring western European production, was at best a partial solution. The sterling area was neglected and when the United States suffered a mild recession in 1949 it was thrown into a financial crisis. The United Kingdom and the dominions devalued their currencies after the economic talks in Washington in September. But devaluation would only be successful if the United States accepted that more imports from the sterling area, and not the constant expansion of unrequited exports, was necessary to restore the health of the non-communist world. The government did not know whether the Americans had accepted this and were inclined to be pessimistic.

Chifley's reaction to all this was to stand by Britain and not to attempt to forge a new economic relationship with the United States. His government accepted the dollar import cuts recommended by the Commonwealth finance ministers. And with government and opposition equal in the polls, he moved to restore petrol rationing. The decision tipped the balance against Labor. Menzies and Fadden campaigned on a theme that Chifley's dollar policy was negative and uncritically supportive of 'socialist' Britain. The parties of imperial patriotism, and the erstwhile critics of multilateralism began to espouse a new philosophy: the abolition of petrol rationing, dollar loans, increased production, and the repudiation of the London agreement. They argued that
value had to be put back into the pound – inflation curbed, and the Australian pound, implicitly, revalued. In a period of cold war and growing fear of the outbreak of global war, the coalition parties campaigned successfully against Evatt’s foreign policy, advocating increased defence preparedness and a realist foreign policy. They promised to ban the Communist party and curb what they saw as political strikes. While there was agreement between Labor and non-Labor on many things – a large immigration programme, the welfare state in the form that it had emerged, sympathy with Keynesian principles – there was also a serious disagreement about the issues of depression and war. If the 1949 election was not a watershed, it was nevertheless a significant turning point in Australian history.
CHAPTER FIVE - PREPARING FOR WAR

The Menzies ministry took over the reins of government in December 1949. Menzies became prime minister and Fadden, the leader of the Country party, became treasurer. The high profile Liberal member for Warringah, Percy Spender, was given the portfolio of external affairs. Eric Harrison, the deputy leader of the Liberal party was given defence, but was soon to be replaced in that portfolio, when he went to London as resident Australian minister, by the South Australian Liberal, Philip McBride. The ruthlessly efficient deputy leader of the Country party, John McEwen, became minister for commerce and agriculture, and the young Victorian Liberal, Harold Holt, took on the portfolio of labour, national service, and immigration. John Spicer, a Liberal senator, became attorney general. The department of postwar reconstruction, the purpose of which had been to develop plans for the construction of a new social and economic order in Australia, was replaced by a department more in keeping with Liberal and Country party philosophy – national development. R.G. Casey, a former United Australia party minister and president of the Liberal party was given the new portfolio.

The change of government was a change away from a Labor government which while generally in favour of liberal capitalism, maintained a staunchly pro-British and pro-sterling area economic policy and attempted to retain as many of its wartime economic powers as possible, in the interests of maintaining full employment and a stable rate of development in the face of declining conditions abroad. The new government did not share the economic outlook of its predecessor, although a disposition to be wary of unfavourable developments overseas continued to feature in the thinking of some of the bureaucrats who advised Menzies. The coalition government decided to pursue an economic policy unhampered by the fear of depression. The idea of building a new social and economic order in Australia and a new world order based on internationalist liberalism and full employment gave way to new principles. Australia’s development and immigration plans would go on at an even
faster rate, but Australia's main task was now to fit into Anglo-American strategic plans and to prepare for war. The Menzies government would also endeavour to throw off dependence on the sterling area and forge a new economic relationship with the United States which would allow greater defence preparations and more rapid economic development. While the Chifley government had grave fears of depression it was not worried about the threat of a global war and was not inclined to build up the Australian war effort so as to be able to participate in British strategic plans directed at war with the Soviet Union. The Menzies government totally disagreed. The most profound difference between the two governments was their differing perceptions of the dangers of depression and war.

The new government was seriously concerned about the danger of a third world war arising from communist aggression. And unlike its predecessor, the coalition government had no faith in the United Nations as an institution capable of preserving world peace. Menzies and his colleagues initiated a new policy of preparing Australia for war and basing Australia's security not on the United Nations but on membership of an anti-communist western alliance. Menzies and Spender pursued a 'realist' foreign and defence policy, based on the idea that the only way to prevent war and to beat the enemy if war broke out, was by establishing the superiority of the western allies' defences. The new government wished to foster a new relationship with the United States and in particular to get an American guarantee of Australia's security, and was even prepared to sacrifice solidarity with the British Commonwealth in order to pursue that goal.

The new minister for external affairs, Percy Spender, attended a British Commonwealth foreign ministers' conference in Colombo in January 1950. The British foreign secretary, Ernest Bevin, briefed his colleagues on the international situation. He traced the history of attempts to enlist the cooperation of the Soviet Union since the end of the war, and pointed out how, when it became clear that Soviet policy was to be one of 'nineteenth century expansionism', it had been necessary to develop
western consolidation. He thought that this had succeeded to the point where Russia now appeared to be turning her attention to the east. While Bevin did not think that a Pacific Pact along the lines of the Atlantic Pact would be appropriate to meet the situation in Asia, he concluded that there should be increasing contacts among like minded countries in the Pacific and South East Asian region to meet the Soviet threat. Spender wholeheartedly agreed with Bevin’s assessment of the international situation, though he was much more enthusiastic about the idea of a Pacific Pact. 1

Shortly after his return to Australia, on 9 March 1950, Spender made his first statement on international affairs to the house of representatives. Significantly, he put cooperation with the British Commonwealth and the United States ahead of cooperation with the United Nations. And he argued that in recent times there had been developments which made Asia as likely an object of communist aggression as western Europe. The independence of Pakistan and India, the communist revolution in China, the creation of new national entities in Indonesia, Vietnam, Laos, and Cambodia had, he argued, shifted the centre of gravity in world affairs more and more to this area:

Our policy must be to ensure, to the full extent that we can, that these new states cooperate with each other and with us in meeting positively and actively the new problem caused in this area by the emergence of Communist China, and by the ever increasing threat of communism which endeavours to ally itself with the national aspirations of the millions of peoples of South East Asia.

Spender portrayed the broad global picture as a struggle between the western democratic nations and the Soviet Union. He argued that the basis of this struggle was an aggressive Soviet foreign policy which had as its ultimate aim the achievement of world communism. He was unsure how the new Communist Chinese regime would act but he warned that even if it did not actually invade neighbouring states, it could foment disorder in those countries through the agency of the overseas Chinese. The thrust of his argument was that the Pacific and South East Asian region was as much in danger from communist aggression as western Europe. A solution to this problem

1 Cabinet agendum no. 37, ‘Meeting of British Commonwealth foreign ministers at Colombo’, February 1950, CRS A461/2 T326/1/4, AA.
seemed to be a Pacific Pact. He dismissed the sort of arrangement favoured by Evatt and Burton — a ‘multilateral agreement that had nothing to do with defensive arrangements’ — as of no use. What he envisaged was a defensive military arrangement comprising Australia, other Commonwealth countries and the United States. For Spender the participation of the United States was essential, indeed its ‘participation would give such a pact substance which it would otherwise lack.’ 2 It should be noted that Spender’s concentration on South East Asia was very much a personal view. Menzies, for example, held the view that the main threat to world peace came from the Soviet Union in Europe. But despite their disagreements over strategy, both Menzies and Spender were opposed to the internationalism of the former government.

When Chifley intervened in the parliamentary debate on international affairs he revealed the essential difference between the foreign policies of government and opposition. He contended that a regional defensive pact directed against the possibility of communist aggression in Asia, and indeed the defensive alliance against the Soviet Union in Europe, were of less importance to Australia’s security than the economic reconstruction of western Europe:

Unless Europe is made secure for democratic governments, there can be no safety for people like ourselves. The people of the United Kingdom, with hostile forces poised so close to them, as would be the case if the rest of the world was lost to communism, would be in no position to help us or any other democratic nation.

He was not arguing that western Europe was in danger of a military attack from the Soviet Union, because Russia was in ‘no better position than the western democracies to bear the strain of such a conflict’, but that western Europe was in danger of falling to local communist movements through internal dislocation and decay. This was why Chifley thought that the Marshall Plan was so important. However he did not think that the world’s greatest economic problem – the dollar shortage – could be solved simply by increased production in western Europe:

The problems of the world cannot be solved by increasing production unless the commodities can properly be distributed at remunerative prices, and those arrangements cannot be made under the economic arrangements which exist as between the rouble area, the sterling area, and the dollar area. The problem seems, at any rate for the short term, to be incapable of solution.

Chifley was arguing that the western nations, and particularly the United States, should continue their efforts to rehabilitate western Europe and to reconstruct a viable pattern of world trade. It would be disastrous if the United States was diverted into expensive land wars on the Asian continent or elsewhere. Meanwhile at least in the next ten to twenty years, a depression developing in spite of the creation of a new international economic system, was a more serious threat to Australia’s security than war.3

Evatt reinforced Chifley’s comments, criticizing Spender for his ‘grudging’ and ‘qualified’ support of the United Nations. He admitted that the United Nations had grave defects: it did not have military forces at its disposal and resolutions of the Security Council could be defeated by any one of the great powers. But he pointed to several instances, one of them being Korea, where the United Nations had successfully resolved disputes and stabilized areas of potential conflict. The Menzies government should place more emphasis on the United Nations as the means of settling international disputes.

Australia should not, he declared, act on the assumption that war between the western powers and the Soviet Union was inevitable. Another world war might come, but it was more likely to develop out of local disputes than to be caused by deliberate Soviet aggression. Only the constant vigilance of an international body like the United Nations could settle these localized disputes and prevent them from spreading. Australia’s first duty, therefore, should be to support the United Nations, which would police regional conflicts and prevent them from escalating. Her second task should be to look to the security of her own region. Nothing had changed for Evatt since 1946. Australian foreign policy should continue on its internationalist course and defence

policy should be directed to the defence of the ANZAM region. There was no need for Australia to make military commitments in other theatres. And as for the idea of a Pacific Pact, the United States, as a world power, would not become a member simply to look after Australia's regional concerns. If the Americans were to join such a pact, they would have to be convinced that it had a wider significance. 4

While he was minister for external affairs, Evatt had endeavoured to resist the attacks of the defence department on his internationalist foreign policy. Now that he was out of office, defence redoubled its efforts to convince a much more amenable government that Australia's foreign and defence policies should be conducted in such a way as to counter the imminent threat of communist aggression. On 27 April, the defence committee completed a report on the defence aspects of the prospective peace treaty with Japan. Absent was Evatt's policy of securing the permanent demilitarization of Japan. The defence committee considered that in the face of 'aggressive Russian communism, and the situation in China, the present military threat in the Pacific and Far East is from Russia and China'. The committee agreed with the Americans that any development which would enable Russia to gain control of Japan or to extend communism in Japan, would prejudice the security of the Pacific, and might be a decisive factor in a war in that area. Australia should acquiesce in a limited Japanese rearmament if the Americans in return undertook to ensure the defence of Japan and to establish military bases from whence could be launched a strategic offensive against the Soviet Union or China. In the meantime, American occupation forces should remain in Japan until a satisfactory peace treaty was concluded. 5

The secretary of the department of defence, Frederick Shedden, put Menzies in the picture about earlier negotiations with the British on Commonwealth defence. He informed Menzies of what Chifley had told the British in 1949: that the Australian

5 Peace treaty with Japan – defence aspects*, paper prepared by the defence committee, 27 April 1950, CRS A5954/1 Box 1652, AA.
government would develop general plans to meet immediate and long term military threats on the advice of the defence committee. Chifley had added that before the Australian government would consider, let alone accept such plans, it would be essential to relate them to those of the United States regarding the defence of the Pacific. Shedden pointed out that when the new government finally adopted plans for the disposition of Australia's war effort, it would be accepting a political commitment to provide forces of a certain strength and nature as provided for in the plans. The decision would thus determine the whole pattern of Australia's war effort, defence production, supply planning, and indeed the structure of the civil economy.6

The defence committee produced its report on the disposition of Australia's war effort on 15 June. It argued that a major war in the foreseeable future would be global in character, the major conflicts taking place in Europe and the Middle East. The war might also be fought in the North Pacific and Far East but this would be a much less important theatre.

The defence committee recommended that the available Australian war effort should be employed where it best contributed to the security of Australia in particular and the British Commonwealth in general. The defence committee did not share the view of Evatt and Burton that Australia should be concerned with events in South East Asia to the exclusion of other areas. In a future war, it argued, the threat to Australia would be increased by adverse events in South East Asia, but the security of Australia would depend ultimately on the outcome of the major conflict in Europe and the Middle East, and to a lesser degree of the conflict in the Far East. The Atlantic pact nations were in the best position to provide forces for the defence of western Europe, and the Americans would take care of the North Pacific and the Far East. Apart from internal communist subversion in Malaya, the only military threat to the ANZAM

6 'Planning for cooperation in British Commonwealth defence – visit of Field Marshal Sir William Slim, Chief of the Imperial General Staff', 19 May 1950, CRS A816/1 14/301/431, AA.
region was in a land assault from the north. This would not be likely to occur suddenly and would be evident well in advance.

This left the Middle East. The defence committee concurred with the view of the United Kingdom government that Australian forces could most usefully be deployed in that theatre.

In the opening stages of a war, the greatest danger, in areas of direct interest to Australia, is likely to exist in the Middle East, unless adequate forces can be deployed there in time. The security of the Middle East in the critical early stages, and ultimately the security of Australia, might be adversely affected if Australian forces were withheld unnecessarily to meet a possible threat in Malaya.

The committee therefore recommended that the Australian government develop alternative plans concurrently for the deployment in the Middle East of the first army contingent and air force task force raised, with provision for later forces to be allotted to Malaya, should a threat develop there; and for the deployment in Malaya of the first army contingent and air force task force raised, with provision for later forces, not required in Malaya, to be sent to the Middle East.7

Sir William Slim, chief of the imperial general staff, visited Australia to discuss British Commonwealth defence in June 1950. Slim reported back to the British government that he first encountered in Australia a tendency to concentrate exclusively on South East Asia. He had, however, explained the ‘vital’ difference between the operations conducted by Japan in the second world war and the operations which the Soviet Union was likely to conduct in a future war. Japan had been an Asiatic power with command of the sea and thus presented a serious threat in the Pacific, whereas the Soviet Union was not an Asiatic power and was unlikely to conduct major operations in the Pacific zone. He tried to persuade Menzies that war with the Soviet Union would be conducted mainly in Europe and the Middle East, and that it was consequently essential that joint planning between Australia and the United Kingdom should be based on the

7 Defence committee report on a ‘Suitable basis for the distribution of strategic responsibility and war effort’, 15 June 1950, CRS A5954/1 Box 1682, AA.
assumption that the Middle East would be the crucial theatre. Menzies agreed with
Slim's argument, particularly since it had governed his own policy in 1939 and 1940,
but he warned that it could not be taken for granted that it would be accepted in all
sections of the Australian community. The conclusion reached between Slim and
Menzies was that the despatch of troops to the Middle East would be a matter for
political decision at the time; but that planning would proceed on the assumption that
they would be sent. Slim was left with the impression that, when the time came, the
political decision would be to send Australian troops to the Middle East. Agreement
between Australia and the United Kingdom for joint planning would significantly
reduce the delay before such troops would begin operations.8

The council of defence met to consider the defence committee's report on 21
June. The committee's report contained two political judgements with which the
Chifley government would have totally disagreed: that the Middle East and Europe
were of greater strategic importance to Australia than South East Asia; and that
Australia should rest assured that the United States would take strategic responsibility
for war in the Far East and the Pacific, allowing the Australian war effort to be
deployed elsewhere. The new council of defence accepted the committee's report. It
recommended that Australia join with the other Commonwealth countries, the United
States, and western Europe in organising essential deterrent forces, and in working out
military plans against the possibility of communist aggression, in accordance with
article 52 of the United Nations charter. This was just the policy which Chifley and
Evatt had sought to dissuade the British from adopting in 1948. The council agreed that
it was vital for the western powers to be able to deliver air offensives against the Soviet
Union from the outbreak of the war, and thus to hold the bases and sea areas essential to
the launching of those air offensives, particularly in Japan and the Middle East. It
approved Australian military planning to implement allied strategy but made it clear

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8 Minute of meeting between the British cabinet and Menzies, 14 July 1950, Public Record Office
London PREM 8/1148. I am indebted to C.D. Waters for this reference.
that those plans would not commit the Australian government unless it subsequently adopted specific plans. The council accepted Australia’s responsibility for home defence and the defence of the ANZAM region, but also endorsed the defence committee’s recommendation for drawing up plans concurrently for the defence of Malaya and the Middle East. 9

In the middle of the Menzies government’s deliberations about Australia’s strategic role in a future global war, the North Korean communist regime launched a full scale invasion of South Korea. On 27 June the United Nations Security Council passed a resolution calling on UN members to contribute to the defence of South Korea. Since the Soviet delegation was absent from the Security Council in protest against the exclusion of communist China from that body, the resolution was not subject to a great power veto. The Australian government decided not to participate in the allied defence of South Korea so as to concentrate its efforts on the new national service scheme and on making preparations for the global conflict in which Australia was expected to contribute troops to the Middle East. 10

In July Menzies visited London on the way to Washington where he would attempt to secure a large dollar loan. He told the British that the Australian government regarded the civil insurrection in Malaya as of greater importance to Australian security than the war in Korea. His government was determined not to send ground forces to Korea. The United Kingdom government conveyed to Menzies its reservations about the idea of a Pacific Pact. In the present circumstances it would at best be a ‘White Man’s Pact’ comprising the United States, the United Kingdom, Australia, and New Zealand. A pact without Asian participation would in effect be an acknowledgement that in time of major war, the white nations were doubtful about

9 ‘Planning for cooperation in British Commonwealth defence – conclusions of the council of defence’, 21 June 1950, CRS A5954/1 Box 1682, AA.
10 Cablegram 464 Spender to Makin, 29 June 1950, CRS A816/1 19/323/13, AA.
Asian participation, and it could even foster the delusion in Asia that neutrality was possible. 11

During Menzies’ sea voyage to the United States, Fadden and Spender reversed the decision not to send ground forces to Korea. After Menzies left London, The British government decided to commit troops to Korea. When Spender and Fadden learned this, they decided that Australia could not afford to lag behind the United Kingdom in supporting the United States. Spender noted: ‘such offers as this might have little effect from the military point of view but considerable effect as a gesture...time in Korea is rapidly running out and if we refrain from going any further now, we may lose an opportunity of cementing friendship with the US which may not easily present itself again.’ 12 The government’s decision to send ground forces to Korea had nothing to do with loyalty to the United Nations, or with an assessment that the war in Korea was at all strategically important to Australia. It made the decision to foster a better economic and political relationship with the United States.

The Labor opposition gave its wholehearted support to the Menzies government’s assistance of the United Nations in Korea. Chifley took the opportunity to argue that the United Nations’ intervention in Korea vindicated the former government’s support for internationalism. The Korean case, he said

will prove that when world peace is endangered by a dispute between two countries, the trouble can be settled by mediation and conciliation. It will show that when one or other of the disputing parties is not prepared to conciliate or mediate under the auspices of the United Nations, then the other members of the organisation will play their part in nullifying acts of aggression. 13

He thought that there was no reason why the Korean situation should start a third world war and he obviously doubted that the North Korean invasion was directed from Moscow. Indeed he considered that the action of the United Nations in Korea would prevent a major war. In praising the intervention of an international task force to settle a local dispute, Evatt and Chifley glossed over the fact that the United Nations had only been allowed to act militarily in Korea because of the temporary and fortuitous absence of the Soviet Union from the Security Council.

The United States government was uncertain about whether the Korean conflict might be the start of a global war, though it had no doubt that the Soviet Union was behind the North Korean invasion. On 25 August the American national security council (NSC) prepared a report for the president on the possible consequences of the Korean situation. The report concluded that the North Korean attack on the South was open to two interpretations. The first was that the Kremlin ordered the attack without intending to start a global war, but simply to gain control of the Korean peninsula and thus strengthen its position in northern Asia. The second interpretation was that the Soviet Union was waiting until the United States reached the point of maximum diversion and attrition of American forces in Korea, before launching a full scale assault on western Europe. The NSC speculated that a global war in the near future could come about in three ways: by Soviet design; by a progression of developments arising out of the situation in Korea; or by a miscalculation on the part of either the Soviet Union or the United States. To meet this eventuality, the NSC argued that

The United States should as rapidly as possible increase the build up of its military and supporting strength in order to reach at the earliest possible time and maintain for as long as necessary a level of consistent military readiness to support US foreign policy, to deter Soviet aggression, and to form the basis for fighting a global war should war prove unavoidable.

The Australian government also committed itself to greater defence preparations. The acting minister for defence, Philip McBride, argued on 23 August

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that recent events in Malaya, Indochina, and especially Korea, meant that the world had passed into a period of intensified cold war, with greater risks of becoming a global war overnight. The winning of the cold war and the possibility of a hot war required an acceleration of defence preparations for the transition of Australia to a war footing. The United Kingdom had recently increased defence expenditure from eight to ten per cent of her national income and the United States had increased military expenditure from six to ten per cent of her national income. Australia spent £64 million or 2.9 per cent of her national income on defence in 1949/50. The Menzies government decided to adopt a three year defence programme composed of the last two years of the Chifley government’s five year plan plus the additional expenditure which the government deemed necessary for greater defence preparedness. The new programme had to provide for national service training, expanded citizen and permanent forces, and a large stockpiling programme. This meant an average yearly expenditure of about £100 million (about five per cent of Australia’s national income) as compared to about £50 million under Chifley.  

Having returned from his discussions overseas with the British and Americans, Menzies persuaded his colleagues that war was a possibility. The new government would abandon Labor’s internationalist foreign policy and regional defence policy in favour of forward defence: Australia would be defended in distant theatres in combination with its chief allies. In three radio broadcasts on 20, 22 and 25 September, Menzies issued a dramatic ‘defence call to the nation’. He used one of the interpretations adopted in the NSC paper of 25 August: events in Asia were part of a deliberate Soviet strategy of weakening and dispersing the western war effort, before a massive Soviet assault on western Europe. If the Soviet Union went to war, he said, it would strike like lightning. In the meantime it was using puppet regimes in other countries to attack other nations. If a third world war broke out, Australia had to meet the enemy’s attack where it came. He went on

15 ‘Australian defence preparedness’, 23 August 1950, CRS A5954/1 Box 1558 AA.
This then, is the first thing which it is my duty to make clear. Those who argue about military service overseas, as if it were anathema to some popular instinct, are living in a dream world. Australia’s defence policy must be part of a western democratic defence policy, or it will be nothing.

Menzies declared that if there was to be a third world war in the next few years, it would come as the result of communist aggression. Since the communists had no sea power capable of launching an invasion of Australia, the purpose of the Australian army was not to repel a land invasion, but to cooperate with western democratic nations in other theatres of war.

In brief, and I say it quite bluntly, an Australian Army raised only for service in Australia would, in all probability, be raised for no service at all. It would be the equivalent of a wooden gun. And the democratic world cannot afford to have its common front against communism weakened by the withdrawal into useless isolation of some of the best troops in the world. 16

In September the government launched a recruiting campaign to build up the permanent and reserve forces. It also decided to enlist into the Australian army only those who volunteered to serve anywhere in the world. This was a crucial reform because it would allow the government to send the Australian army to the Middle East or to other regions in Asia without delay. Menzies did not attempt to amend the defence act to make this change. One reason for this was that he wanted bipartisan support for the recruiting campaign. Another was that Labor controlled the senate and would have been sure to veto an attempt to amend a provision that had been enshrined in Commonwealth law and in Labor politics since the early days of the Commonwealth. Menzies would have been less sure of fighting a double dissolution on the defence act than on the communist party dissolution bill.

In any case, Chifley was implacably opposed to Menzies’ reforms in defence. He pointed out to Menzies that, under Labor’s defence plan,

it was never intended that the soldier should be placed under an obligation to serve anywhere in the world. On the contrary the very foundation of the

Australian army was the military defence of the continent and the arc of islands placed under Australia's authority. 17

Menzies argued that this policy left Australia unable to mobilize troops quickly to meet aggression. In reply, Chifley declared that Australia's military programme had to be limited. Otherwise the government would simply load Australia down with debt, and retard the development and immigration programmes. The greatest measure of security which Australia could have in the next two decades – for he did not believe in the likelihood of war in the next few years – was a larger population and greater development of the country's resources. Since Australia itself was in no danger of attack, there was simply no need for an enlargement of the defence programme or of a change in the conditions of service in the army. 18

Shortly after his return to Australia, Menzies asked the chiefs of staff to advise him on the strategy Australia should adopt in relation to communist expansion in the Pacific, South East Asia, and the Far East during the period of cold war. The chiefs pointed out that although NATO provided a basis for cold war strategy in western Europe, there was nothing comparable for Asia and the Pacific.19 Events in Korea in the cold war constituted a test case for the struggle against communism in the Far East. The existing Australian commitment of one battalion to Korea, though only a token force, was worthwhile because of the political value gained by Australia fulfilling her obligations to the United Nations. But if China or the Soviet Union were to enter the war in large numbers, the allies should be pulled out of Korea altogether. Like the Americans, the Australian chiefs did not regard Korea as of great strategic importance in a wider war. American policy in the event of Chinese intervention was to try to avoid a general war with communist China but to resist in Korea as long as possible and 'take appropriate air and naval action outside Korea against communist China'. 20 The

19 'Australian strategy in relation to communist expansion in the Pacific, South East Asia, and the Far East during the cold war period'. Appreciation by chiefs of staff, 24 October 1950, CRS A5954/1 Box 1682 AA.
chiefs regarded Japan as of much greater strategic importance than Korea because she was a potentially powerful industrial nation which had to be kept out of the communist orbit and because she could provide bases from which the United States could launch an air offensive on both China and Russia. This was in accord with American policy. The American defense secretary pointed out in July 1949 that if ‘Japan, the principal component of a Far Eastern war making complex was added to the Stalinist bloc, the Soviet Asian base would become a source of strength capable of shifting the balance of world power to the disadvantage of the United States.’

The chiefs of staff regarded Indochina as the front line of the cold war in Asia. They argued that

if that gives way it is only a matter of time before Siam and Burma fall under communist influence and an invasion route to Malaya lies open to the communist forces. From the military point of view, because of its effect on the defence and security of Malaya, Indochina occupies an important position in our strategy, for the cold war as well as the hot war.

At this time United States policy, in the event of an attack by communist Chinese forces on Indochina, was to avoid becoming engaged in a general war with China, but to accelerate and expand American military assistance to Indochina in concert with the United Kingdom and France. The Australian chiefs, similarly, recommended limited economic assistance to the French in their war against the communist Vietminh. They regarded Malaya as the most strategically important country to Australia in both cold and hot war. This was because, in their words

It is the land route leading from Asia to the arc of islands to the north of Australia. Its loss would mean that communist influence, and power, would come within striking range of Australia; the Allies would lose the focal point for the control of the sea route between the Indian and North Pacific oceans and they would be deprived of their best sources of rubber and tin.

They recommended confining military assistance in the cold war in Asia to Japan, Korea, and Malaya. And they gave priority to Malaya over Korea because of its greater strategic importance to Australia. The chiefs of staff were thus recommending

21 Quoted in Pemberton, op. cit., p.23.
not only that Australia should make a commitment to the defence of the Middle East in a
global war, but also that it should be ready to assist the western powers in wars
against communism in certain parts of Asia in the cold war. McBride commented to
Menzies that planning for the cold war in Asia was hampered by the lack of defence
cooperation between the United States and Australia, and that there was urgent need
for a defence relationship with her powerful ally. 23

In November 1950 the government introduced its further major change to
defence policy – national service. On 21 November, Harold Holt, the minister for
labour and national service, introduced his national service bill into the house of
representatives. He explained that national service would provide a substantial
reservoir of persons trained in the latest methods of warfare, who would be available
to be recruited for service in the defence force in the event of a major war. National
service trainees were not, however, liable for overseas service. Holt argued that a
national service scheme had to be introduced because of the inadequacy of the Chifley
government’s defence programme, which was ‘not enough and appeared to rely too
heavily on scientists, a few specialists, and small permanent service cadres.’24 Replying
for the opposition, Evatt disputed the need for compulsion in the raising of Australia’s
defence forces and argued that the government should concentrate Australia’s scarce
resources on developing industries. He promised that the Labor controlled senate
would block the national service bill.25 Subsequently, however, the ALP Federal
Executive voted by a narrow margin to support the principle of compulsory military
training, and the senate passed the bill.

It was at about this time that the Korean war took a dramatic turn for the worse.
In his speech to parliament on 27 September Menzies said that United Nations forces in
Korea would be fully justified in moving beyond the 38th parallel into North Korea.
The issue was ‘not a mere geographical question to be solved by some abstract process;
it is a practical military problem, and its solution will turn on how far the invasion of

23 McBride to Menzies on chiefs of staff appreciation, 24 October 1950, CRS A5954/1 Box 1682 AA.
25 CPD, Vol. 211, 29 November 1950, pp. 3312–21
South Korea has been genuinely and permanently overthrown.' In reply, Chifley attacked Australian and American policy in the Far East. He declared that the United States had made a grave mistake in not admitting communist China to the United Nations. Were the United Nations forces to go beyond the 38th parallel, they would themselves become aggressors. His alternative was to establish an occupation force in South Korea and to reestablish the South Korean government, however unpalatable that might be. If in government, Chifley would have put Australia beside India in opposing the movement of UN forces into North Korea.

As it was, on 7 October 1950, an eight nation western resolution in the General Assembly of the United Nations, sponsored by Australia among other countries, called for all ‘appropriate steps’ to be taken to ensure ‘conditions of stability throughout Korea’, and for elections under United Nations auspices to establish a ‘unified, independent, and democratic government’. This was the necessary go ahead for general MacArthur, commander-in-chief of UN forces in Korea, to cross the 38th parallel into North Korea. Ironically, the United Nations was appearing to authorize the unification of Korea by force against North Korea, after it had resisted the attempt of North Korea to unify the country by force against South Korea. On 19 October UN forces captured the northern capital of Pyongyang. On MacArthur’s insistence, and against the better judgement of most of the Truman administration, the American joint chiefs of staff authorized the bombing of power plants and bridges on the Yalu river, near the border with Manchuria. This was part of MacArthur’s strategy of driving communist forces into Manchuria and preventing their re-entry into Korea. The American general then moved his forces towards the Yalu to clear the border area, while the administration sat nervously watching the Chinese reaction. On 25 November the Chinese launched a massive attack on UN forces in North Korea.

\[26\] CPD, Vol. 209, 27 September 1950, p.21
The Chinese drove the UN forces out of Pyongyang, and then out of Seoul, the southern capital. Indeed the Chinese offensive had the potential to drive the UN forces off the entire Korean peninsula. The Truman administration debated what to do. The United States could not now fulfill the United Nations objective of restoring peace and security to Korea except at the cost of an all out war against communist China. But nor could she abandon Korea without losing face, and as the administration saw it, caving in to communist aggression. Moreover the government had to think very carefully about destroying the enemy’s air bases in Manchuria. Such a step might bring the Russians in to aid their Chinese ally, without actually declaring war on the United States. President Truman promised to resist the Chinese ‘aggression’ and even envisaged the possibility of using the atomic bomb in Korea. In a message to congress on 1 December, he urged the appropriation of $1,050 million for producing fissionable materials for an atomic weapons stockpile. The danger of a third world war was never greater than in the few months after the Chinese intervention in the Korean war. Ironically, this danger arose not from the Soviet assault against which the Australian and other western governments were preparing. It arose from the circumstances of the war in the Far East, which until November, the Menzies government had been treating as a sideshow.

So concerned was the United Kingdom government about the possibility of a third world war triggered by American policy in the Far East, that Attlee made a special visit to see Truman in Washington in December. In the first meeting on 4 December, Attlee impressed upon Truman the need for a cease–fire in Korea and for negotiations with the Chinese. He was anxious that the Americans not be drawn into a war with China in the Far East, leaving western Europe defenceless against the Soviet Union. Secretary of state Dean Acheson countered that in the negotiations following a cease–fire in Korea, the Chinese might demand Formosa from the nationalists, and a

29 Memorandum of conversation by the ambassador at large (Jessup), Notes on NSC meeting, 28 November 1950, FRUS, Volume VII, 1950, pp.1242–8.
seat in the United Nations, and that no Japanese peace treaty could be concluded without their assent. He added that the Chinese were not looking at the Korean issue as Chinese but as communists who were subordinate to Moscow. He stressed that the United States could not surrender in Korea and that foreign policy in relation to the containment of communism in the East could not be separated from containment of communism in Europe.  

In the second meeting on 5 December, Attlee joined battle with Acheson over his suggestion that without actually declaring war on China, the United States would do all she could to impede them by an economic blockade and other measures. Attlee thought that the Chinese would respond by mobilizing their armies against Indochina, Malaya, and Hong Kong. He advocated the alternative policy of recognizing China, seating her at the United Nations, and ceding Formosa back to the mainland.

At the meeting on 7 December, Attlee reaffirmed British opposition to a limited war with the Chinese. The Americans replied that war with China would be contingent on UN forces being driven out of Korea altogether. Defense secretary Marshall declared that if there was any way of avoiding war with China, he would take it because America was faced with the threat of a global war. But he greatly feared that if the United States negotiated with China, Formosa would end up in enemy hands and Formosa would be of immense strategic importance in the event of a global war against the communists. Marshall did not draw up any detailed plan of action against China, but one suggestion was for a possible naval blockade and air action against certain points on the mainland. Attlee replied that this would inevitably lead to the Soviets coming to the aid of their ally, and thus to a global war.

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30 The United States delegation minutes of the first meeting of Mr Truman and Mr Attlee, 4 December 1950, FRUS, Volume VII, 1950, pp.1361–74.
31 United States delegation minutes of the second meeting of president Truman and Mr Attlee, 5 December 1950, FRUS, Volume VII, 1950, pp.1392–1408.
32 United States delegation minutes of the fifth meeting of president Truman and prime minister Attlee, 7 December 1950, FRUS, Volume VII, 1950, pp.1449–6.
The Truman–Attlee talks were inconclusive. But Truman had raised doubts in the administration about war with China. In late December the American joint chiefs of staff did just what Attlee was advising against: they recommended the withdrawal of the UN from Korea followed by a limited war with China. As before the war, they regarded Korea as a strategic backwater and thought it more important to preserve American ground forces for the defence of Japan and western Europe. Truman and his civilian advisers disagreed with the military. They stuck to the strategy of holding a line in Korea and avoiding war with China. However they compromised with the chiefs of staff by authorizing MacArthur to continue fighting a local war in Korea but to withdraw his forces to Japan in the event of a massive Chinese assault beyond the 38th parallel. 33 On 8 January Attlee became so concerned with the trend of events in Korea that he asked Truman whether he had authorized the UN commander to evacuate Korea rather than fight it out. 34

It was in these circumstances that the Commonwealth prime ministers’ conference was held. The aim of the United Kingdom government in calling the conference was to get the other Commonwealth countries to agree that if a global war came, an anti–Soviet strategy was paramount. The British wanted to secure a Commonwealth commitment to the defence of the Middle East. They also were happy to tell the Asian dominions that their views about the danger of provoking a war with China in the Far East were being given full and sympathetic consideration. 35

Attlee opened the conference with a review of the general international situation. He declared that the Far East was now the main danger point from which a global war might emerge. In his talks with Truman, he had endeavoured to stop the Americans from being drawn into a war with China. Such a war would inevitably result in

34 The British prime minister (Attlee) to president, 8 January 1951, FRUS, Volume VII Part 1, 1951, pp.37–8.
35 The attache in the United Kingdom (Tebbitt) to the secretary of state, 29 January 1951, FRUS, Volume IV, 1951, pp.906–7.
disaster, since it would be a long drawn out struggle and and would immobilize the American and allied forces in Asia, leaving the Soviet Union a free hand in Europe. The Americans, while anxious to avoid a major war, had shown some readiness to consider a ‘limited’ war with China. Such a position was, in Attlee’s view, dangerous: a ‘limited’ war could never be controlled or localized and would be bound to turn into a major war. If there was not to be a war in the Far East, the allies would have to negotiate with China. 36

When it came to Menzies’ turn to speak, he argued that the British Commonwealth should not allow a serious difference of opinion with the United States to develop, since the Commonwealth could not fight a major war without the United States. If the allies were not to accept a humiliating expulsion from Korea, they had to think seriously about negotiating with China. However the allies were already at war with China, and if the British Commonwealth reached agreement on a formula for negotiation with China on a basis inconsistent with United States policy, the announcement of that formula would have a disastrous effect. He advised that the Commonwealth should concert its Far Eastern policy with the United States. For Menzies, the Commonwealth had three tasks at the conference. First, it had to make up its mind about the Korean situation and the strategic importance of Formosa. Second it had to decide where it stood in relation to Asia generally. Menzies differed with the leaders of the Asian dominions about Asian nationalism. He did not assume that nationalism in Asia would produce peaceful and neighbourly states on Australia’s ‘frontier’. Third, Menzies thought that the Commonwealth should make some attempt to reach an understanding with the Soviet Union, which would prevent a global conflict. 37

36 Minutes of the first meeting of the Commonwealth prime ministers’ conference, 4 January 1951, CRS A1209/23 57/5227, AA.
37 Ibid.
On 5 January Bevin again explored Far Eastern policy. He said that if he were asked publicly to declare China an aggressor, and to shape his policy on that basis, his answer would be ‘no’. A declaration by the United Nations that China was an aggressor in Korea had implications which Bevin wished to avoid. China, for instance, might so conduct its war in Korea as to bring the Soviet Union into the conflict. The western allies would then find themselves compelled to assent to attacks on Chinese territory as the source of the manpower and supplies deployed in Korea. This would inevitably cause a serious escalation of the conflict. Bevin circulated a set of proposals for resolving the conflict in Korea: there would be a ceasefire in Korea, the offer of Chinese representation at the United Nations, the phased withdrawal of Chinese and United Nations forces from Korea, the election of a government in unified Korea, and the eventual cession of Formosa back to mainland China. 38

In discussing Bevin’s proposals, Menzies made a surprise admission. He agreed with the Indian prime minister, Nehru, that the Chinese people’s government had the support of the Chinese people. And he revealed that it had been suggested to him that Australia should withdraw recognition from Chiang Kai Shek in Formosa as a first step in the eventual recognition of the people’s government. But he doubted that the Chinese government could be recognised without some sort of protest against the aggression that they were undertaking in Korea since they had crossed the 38th parallel. Menzies came close to adopting the American line that negotiating with the Chinese would be ‘rewarding aggression’. To put it in Evatt’s terminology, Menzies thought that ‘justice’ compelled the recognition of China, but that with Chinese intentions towards Asia unknown, the ‘expediency’ of defending Australia’s ‘strategic frontiers in Asia’ militated against such a course.

On 8 January Bevin reported to the conference that the Americans had reacted unfavourably to his suggestion that the General Assembly delay discussing the Korea

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38 PMM(51)7, 5 January 1951. Minutes and memoranda of the Commonwealth prime ministers’ conference, CRS A1209/23 57/5227, AA.
question. The Americans were determined to go ahead and brand China an aggressor. They informed Bevin that they would do their utmost to prevent hostilities spreading in the Far East, but American public opinion demanded the condemnation of the 'aggression' of China. Otherwise the United Nations would be fatally discredited and an aggressor appeased. Eric Harrison, the resident minister in London deputizing for Menzies during his absence with influenza, agreed with the British that UN forces should establish a bridgehead in Korea before negotiating a ceasefire. He also agreed that a general war with China should be avoided and that Formosa was not worth fighting over. He was adamant, however, that negotiation with China could not proceed unless the United States agreed with the Commonwealth peace proposals. This was 'essential to prevent the United States from retreating into isolation, in disillusionment at the outcome of the effort in Korea.' Nehru immediately objected that the British Commonwealth should press ahead with a peace programme in Korea without the United States.39

On 11 January Bevin reported that the Americans were insisting that a ceasefire in Korea be a prerequisite to the holding of a great power peace conference to resolve problems in the Far East. The Chinese, on the other hand, said that they would reject any proposals which included provision for a ceasefire before the great power talks. Bevin reluctantly agreed to support the United States and to include provision for a ceasefire in the terms conveyed to the Chinese. Nehru interposed that the Chinese would reject the terms and the Americans would feel justified in bringing forward their condemnatory resolution against China in the United Nations. 40 The conference thus ended with the British Commonwealth not taking a unified stand on the question of ending the war in the Far East. Menzies was the prime minister who was most adamant

39 Minutes of the fifth meeting of the Commonwealth prime ministers' conference, 8 January 1951, CRS A1209/23 57/5227, AA.
40 Ibid., minutes of the tenth meeting of the Commonwealth prime ministers' conference, 11 January 1951.
that the Commonwealth should not make a Far Eastern policy inconsistent with that of the United States.41

By mid January the situation in Korea had improved sufficiently to make the Americans feel confident that they would not be pushed out of Korea altogether. The United States proceeded confidently with its resolution branding China as an aggressor in the United Nations and requesting the UN collective measures committee to consider what additional measures could be used to carry out the purposes of the resolution. While the British government could just barely agree to the condemnation of Chinese 'aggression', it did not agree that the UN should consider additional measures against China and thus abandon hopes of a negotiated peace. But Bevin warned his cabinet colleagues that if the Americans were beaten on this issue, they would retreat into an armed isolationism: 'we have to imagine what it would be like to live in a world with a hostile communist bloc, an uncooperative America, a Commonwealth pulled in two directions and a disillusioned Europe which would be deprived of support in the form of American troops and American involvement in active European defence.'42 The British government therefore supported the American resolution but tried to introduce some amendments. The Australian cabinet did not support the British amendments. Spender accused Peking of trying to gain by negotiations what she had failed to achieve by force and Australia voted on 1 February for the United States resolution condemning China.43

Menzies returned to Australia to announce the danger of war within three years. On 1 March the government approved an increase in the call-up for national service to yield by June 1953, a total strength of 187,137, a strength which the services had proposed for mobilization in the event of war. In a speech to the house of

41 *The attache in the United Kingdom (Tebbitt) to the secretary of state, 29 January 1951*, *FRUS*, Volume IV, 1951, pp.906–7.
representatives on 7 March 1951, he explained briefly Australia’s policy towards the
Korean crisis but devoted the bulk of his speech to the danger of a global war. He
declared: ‘it is my belief that we cannot, and must not, give ourselves more than three
years to defend ourselves’. He argued that in a war with an enemy which would not be a
major naval power, Australia’s own shores were fairly secure. And so

It follows that the defence of Australia will eventually turn upon the
success with which the British Commonwealth, the United States and the
nations of western Europe can turn back and defeat the aggressor.
Wherever there is a crucial theatre of war in such a fight, there will the
security of Australia be defended. Having this in mind, let us acknowledge
that we have vital interests in western Europe, in the safety of the United
Kingdom, and in the Middle East, and that in addition to our vital interests
near at hand we have, during the "cold" war period, a deep concern not
only in Korea but also in Malaya and the South East Asia area generally.

Menzies argued that a number of events in the previous six months had increased the
possibility of war. The first was the weakness of western Europe’s defences. The
second was the considerable progress which the Soviet Union had made in the
development of atomic weapons. The third was disturbances in the Middle East,
particularly in Egypt and Pakistan. Fourth was the turmoil in South East Asia – in
Korea, Malaya, and Indochina. And lastly there was the massive increase in defence
expenditure by the United States and the United Kingdom. Dealing with defence
planning, Menzies hinted that Australia would play its military role in the Middle East:

I express the view of my government quite simply when I say that we have
our own beliefs as to where the major theatres of conflict will be in the
event of another great war, assuming that that great war is with the
potential enemy [the Soviet Union] now visible and occurs, as well it may,
within a relatively short period of years.

He made it clear, however, that despite the government’s definite views on likely
theatres of war, he had declined to make an absolute political commitment to one
theatre which might bind a successor. 44

Menzies’ call for greater defence preparations to meet the danger of war within
three years was not driven by fear of a direct attack on Australia. The joint intelligence

committee (JIC) had advised him in November 1950 that there was no possible threat to the mainland of Australia up until 1957. The JIC’s strategic appreciation assessed the threat to the ANZAM area in the event of war between the Soviet Union and the western powers either before 1952 or between 1952 and 1957. It now assumed that China would be the ally of the Soviet Union and that China would seek to establish communist control in all countries of the Far East and South East Asia which were not already communist dominated. The Soviet Union’s general strategy would be to fight a full scale aggressive war on her western and southern fronts with the object of overrunning western Europe and the Middle East. It would only have limited operations in the Far East.

With their available forces in the Far East, the Soviets would probably occupy South Korea and key bases in China, and would exert the maximum possible pressure on Japan, the Ryukus, and the Aleutians. The Chinese, on the other hand, would be able to mount a significant invasion of South East Asia. The JIC concluded that by 1952, the Chinese communists would be able to make available two field armies (500,000 men) for operations in South East Asia. One of their armies would be required for operations against the French in Indochina. The other army would subjugate Thailand and Burma and concentrate in the Bangkok area for operations against Malaya so as to ensure a numerical superiority of two to one over the British garrison there. In the worst possible case, the Chinese could reach the Kra Isthmus six to eight months after the build up of forces beyond the South China border. But while the Chinese could mount an operation against Malaya, they would be unable, for lack of sea power, to invade mainland Australia. The Soviet Union would be able to assist them, but only to the extent of air and submarine harassment of sea communications in the ANZAM region. 45

45 Joint intelligence committee appreciation 6/49 revised November 1950, ‘Strategic planning in relation to British Commonwealth defence – probable form and scale of attack against and within the ANZAM region’, November 1950, CRS A1068 T4 DL 47/5/1, AA.
Menzies' declaration of the danger of 'war in three years' was designed to do three things. First it would let the British and the Americans know that Australia was serious about playing a more than token role in the western anti-communist alliance. In return Menzies hoped that Australia would be given access to the global military planning of the allies, and that the United States would give Australia a guarantee of safety against either a resurgent Japan or communist aggression in Asia and the Pacific. Second, it would make more palatable the military build up necessary to fulfill a commitment to the British for the defence of the Middle East. Third, it would establish the political divide between government and opposition at the coming election: the government would be committed to preparing for an imminent war and the opposition dragging its heals and clinging to the notion of preparing for depression.

Chifley replied to Menzies in a speech which revealed the core of the disagreement between government and opposition going into the 1951 election. He did not think that there was any danger of an early war in Europe despite what Menzies had said. Nor did he think that a world conflict would arise out of the situation in Asia and the Far East, if common sense were used. He criticized the UN forces in Korea for going beyond the 38th parallel and attempting to subdue North Korea. With most of the electric power in Manchuria supplied from hydro-electric power plants in North Korea, Chifley considered it inevitable that China, in order to protect her vital interests, had been drawn into the Korean conflict. He argued for a speedy end to the Korean war, the arrangement of free elections in South Korea, and the withdrawal of UN forces. The message of his speech was that war with the communists was not inevitable, and that it was not wise for Australia to mimic the excessive defence preparations of the United States and the United Kingdom.46 Like his former adviser John Burton, he seems to have thought that Australia should follow India and other Asian countries in remaining neutral during the period of cold war. If and when the

great powers joined battle with each other, Australia would decide on the strength and strategic disposition of her war effort.47

On 17 March the governor-general conceded a request from Menzies for a double dissolution of both houses of the federal parliament on the grounds of the senate’s failure to pass important legislation. The *Sydney Morning Herald* argued that the election issues were as in 1949: ‘the need to rout the canker of communism from the national life, and the need to ensure, by military preparedness, the safety of the Commonwealth in a war threatened world.’ The *Herald* argued that recent events in Asia should have convinced Australians of the immediacy of the peril of war and applauded the government for ‘responding to the world crisis with a vigorous rearmament programme.’ 48

Chifley determined that one of the main issues on which Labor would fight the election was defence and foreign policy. He declared that under the existing government, Australians would have to face the danger of a rearmed and resurgent Japan, and that international policy would continue to be based on the ‘defeatist’ acceptance of the inevitability of a third world war. He promised that Labor would insist on preventing the rearmament of Japan and ‘would destroy once and for all the totalitarian tendencies of a government which offers to the people of Australia little more than the prospect of wars abroad and inflation and repression at home.’ 49

In his policy speech, Chifley criticized the Menzies government for an inconsistent attitude to the United Nations. He said that cooperation with the United States was important but Australia’s relationship with the United Kingdom should be strengthened. Here he was probably referring to Menzies’ lukewarm support of the United Kingdom in its efforts to avoid a wider war in the Far East. He advocated a return to the policy of support for the United Nations and to the policy of settling

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48 *SMH*, 19 March 1951.
49 *SMH*, 18 March 1951.
disputes by conciliation. He condemned the Menzies government’s ‘expediency’ in foreign policy, using as an example its acquiescence in the rearmament of Japan. And he promised a return to the Dedman defence plan. 50

The Sydney Morning Herald immediately observed that Labor had turned a blind eye to defence and ignored the world crisis:

As far as Labor is concerned, Red aggression in Korea and – nearer to home – in Indochina and Malaya can be completely ignored. So can the fact that all the great democracies have, in the past few months, felt it necessary to revise their defence programmes sharply upwards.51

The situation in Korea was still precarious. MacArthur pressed for authority to bomb targets in North Korea but the administration granted him only a limited authority to move beyond the 38th parallel. In March the United States government edged closer to bringing about a peace settlement in Korea but MacArthur protested ‘any further restrictions on his command’ which would hamper the ability to ‘clear North Korea’ and requested authority to move the seventh fleet closer to the eastern and southern Chinese coasts.52 In late March there was an extensive build up of Chinese troops in Manchuria, coordinated, it seemed, with a large concentration of Soviet submarines northeast of Japan. Truman feared that the Chinese were massing once again to drive the UN forces off the Korean peninsula while the Soviets moved to ‘take the Japanese islands with their submarines and cut off our supply lines to Japan and Korea’. This had the capacity to trigger a global war. Truman authorized the transfer of atomic bombs to military control to be employed against Chinese or Soviet targets.53 The American secretary of defense described the world situation as more serious than in November. And an article in the Sydney Morning Herald predicted that

50 Argus, 29 March 1951.
51 SMH, 1 April 1951.
53 Memorandum of conversation by the director of the policy planning staff (Nitze), 6 April 1951, FRUS, Volume VII, Part 1, 1951, pp.307–9; Schaller, op. cit., pp.335–6.
the war in Korea could easily spread now that the Americans had been authorized to bomb Manchuria in the event of massive air attacks on UN forces.\textsuperscript{54}

The United Kingdom government argued against the UN forces in Korea crossing the 38th parallel. But the Australian department of external affairs thought that they should be able to engage the enemy beyond the 38th parallel with a view to negotiating with the Chinese for the unification of Korea from a position of strength. In a statement of 12 April, Spender confirmed this policy by publicly supporting MacArthur’s crossing into North Korea. He explicitly opposed Chifley's policy statement in the election campaign: the halt of the UN advance at the 38th parallel, the holding of free elections in South Korea as opposed to the whole country, and the withdrawal of UN forces from Korea.\textsuperscript{55} On 11 April the conflict between MacArthur, who was trying to widen the war, and Truman, who had finally agreed to localize the war in Korea, ended. Truman dismissed his Far Eastern general. The Korean war reached a stalemate which was to last until the armistice two years later.

In April the government’s re-election campaign received a great boost when the Americans committed themselves to forming a Pacific security alliance. The traditional interpretation of the formation of the Pacific Pact is that Spender skilfully extracted the commitment from a reluctant United States, exploiting Washington’s wish to get Australia’s signature on a lenient peace treaty with Japan, and its gratitude for Australian assistance in the Korean war.\textsuperscript{56} David MacLean has convincingly refuted this interpretation.\textsuperscript{57} He has shown that the Pacific pact was as much an American initiative as an Australian one – a logical extension of American cold war attitudes. NATO was a regional arrangement designed to thwart Soviet aggression in

\textsuperscript{54} SMH, 1 April 1951.
western Europe. But given American assumptions about the monolithic nature of international communism— that Chinese and South East Asian communism were directed from Moscow— there was, as George Kennan argued, 'no logical stopping point in the development of a system of anti-Russian alliances until the system has encircled the globe and has embraced all the non-communist countries in Europe, Asia, and Africa'. The Menzies government benefited from the Americans' fear in 1950 of a global war with international communism, in which Asia, the Pacific, and the Far East, had to be defended as well as western Europe.

MacLean argues that Spender underestimated the Americans' enthusiasm for a security treaty, and that without the need for blandishments from Spender, the Americans had agreed, in principle, to the idea of a Pacific pact at the end of 1950. The reason for this was that because of events in Asia and the Pacific in that year, the Americans had come to the view that communism had to be contained in the East as well as in western Europe. The Americans thought that a Pacific pact would deter communist aggression in the Pacific. It would also assist the incorporation of Japan into the non-communist world by assuring the Japanese that they would be defended against Soviet or Chinese aggression.  

When Truman authorized John Foster Dulles to negotiate a Japanese peace treaty in January 1951, he also gave him instructions to explore the possibility of a Pacific defence arrangement. At this stage the administration had in mind an offshore island pact including the United States, Japan, Australia, New Zealand, the Philippines, and possibly Indonesia.

The British objected to the offshore island scheme for three reasons: the fear that a Pacific island scheme which excluded the United Kingdom would increase the vulnerability to communism of Hong Kong and Malaya; the fear that a Pacific defence arrangement would make the Pacific dominions unwilling to commit themselves to the

defence of the Middle East; and the more general fear that Britain’s status as a great power would decline if Australia and New Zealand entered into a Pacific security arrangement without British participation. The Menzies government was incensed at the British opposition to the ‘off-shore island’ proposal, fearing that the Americans would be frightened from bringing forward a Pacific alliance of any kind. Spender argued to the British in February that a Pacific pact would not cut across the ability of Australia and New Zealand to reinforce the Middle East. There was in a strict sense no Australian ‘commitment’ to the Middle East. Australia had only agreed to plan on the assumption that Australian forces would be made available in that area. He also tried to assuage the United Kingdom government’s fear that countries on the mainland of Asia might feel excluded from a Pacific pact. He said that Australia would declare, contemporaneously with the conclusion of a Pacific pact, its special interest in the security of Malaya. Moreover he had no doubt that the United States would make a similar declaration of its interest in Indochina. 60

British opposition to the offshore island proposal threw the Americans off balance, and casting round for an alternative to this scheme, they themselves came up with the idea of a tripartite security agreement consisting of Australia, New Zealand, and the United States. 61 The state department was fully aware what an advantage the announcement of a Pacific security treaty would be to Menzies’ re-election on 28 April. The state department did not want a Labor victory, for that would mean that Australia would turn once again to a strongly independent and often doctrinal line in the United Nations, Commonwealth, and other organisations. A Labor victory would hinder United States policy in the Pacific and retard Australia’s defence preparations. The state department noted that Labor had opposed United States policy on such

60 Cablegram 106, Spender to Harrison, 21 February 1951, CRS AS460/1 217/6 Part 2 AA.
61 MacLean, op. cit., p.69.
matters as the recognition of communist China, its admission to the United Nations, and the crossing of the 38th parallel in Korea. If elected, Labor would rely on the principle of United Nations conciliation of international disputes, and it would oppose Japanese rearmament even within the framework of a Pacific pact, which it would not enter except on its own terms.  

The announcement of the formation of a Pacific pact was a great achievement for the Menzies government and undoubtedly contributed to its re-election. On 23 April Menzies argued that if Evatt had negotiated the Pacific pact, it would have been the greatest thing. But it was ours and not his – in fact it was the policy of Mr Spender. I tell you this because no minister for external affairs has done so much as Mr Spender – it was his negotiations which have brought about the pact, though it has not yet been finalized.

O’Neill too represents the establishment of what was to become the ANZUS treaty as the triumph of Spender’s diplomacy. In fact Spender only got what it suited the Americans to give him. Between April and September 1951 the treaty underwent such radical revision as to vitiate some of the main aims of the Australian government’s foreign policy. The American joint chiefs of staff made sure that the Pacific council established under ANZUS would be an entirely civilian body and not a permanent military planning body with access to NATO. They did not want to give Australia and New Zealand equal status in America’s planning process and did not want the United States to be put in the position of making disproportionately heavy military commitments in the Pacific – a region which they regarded as a backwater in the overall global picture. Moreover they did not want the Pacific dominions to become so involved in military planning in the Pacific as to be reluctant to fulfill their military obligations to the British Commonwealth in the Middle East.

The Americans specifically prevented the ANZUS council from being able to form a ‘consultative’ relationship with NATO as the Australian government wanted.

63 Spender, _op. cit._, p.177.
64 O’Neill, _op. cit._, chapter 13.
As Pemberton has argued, the main strategic value that the Americans put on ANZUS was that it allowed the Australians to go ahead with military commitments to the Middle East, without fear of a Japanese military resurgence. The United States was more concerned with the Soviet threat to western Europe than with the communist threat to Asia and the Pacific. Without Asian membership, ANZUS would not provide the framework in which to plan for the security of Asia. The Menzies government wanted an arrangement whereby Australia would be able to contribute to global military planning for the defence of Malaya and Indochina. This would enable it to make a commitment with equanimity to send Australia's entire war effort to the Middle East, while being sure that its own region was protected. The ANZUS treaty did no such thing. The Americans gave Australia a paper treaty which encouraged her to commit her war effort to the Middle East, while remaining adamant that ANZUS would not be a vehicle for planning for the defence of Malaya and Indochina. 65

At a meeting of Commonwealth defence ministers in June 1951, the British put pressure on Australia to make a firmer military commitment to the Middle East. Speaking to a paper on defence policy and global strategy, field marshal Slim argued that Russia's development of an atomic capability had put itself in a better position to launch a full scale invasion of western Europe. Another fact which might provoke Russia to go to war within the next two years was the imminent rearmament of Germany. This made it even more urgent for the British to secure full Commonwealth support for the defence of the Middle East, from which region the western powers could launch a counter-attack against the Soviet Union. McBride replied on behalf of Australia that events in Asia and the Pacific still exerted a powerful influence on Australian strategy. The outcome of the struggle in Korea was still in doubt, and a direct attack by China on Indochina would tip the balance against the French and bring communism closer to Malaya. He was concerned that, in the event of a global war, the British would allow Malaya to fall to the communists in the interests of beating Russia.

first in western Europe and the Middle East. McBride said that Malaya had been lost to the Japanese in the second world war and regained, but if it was once lost to communism, it would never be regained.66

The British attitude to the defence of Malaya was ambivalent. In the event of a local war in South East Asia with the rest of the world at peace, and of a Chinese attack on Malaya, British policy was to hold Malaya with all available resources. However if the Chinese were to attack Malaya at the same time as the Soviets attacked western Europe and the Middle East, the British did not want to denude their forces in the Middle East at the expense of reinforcing Malaya. The British argued that the earliest possible time in which the Chinese could reach Malaya would be ten months after the outbreak of war. Moreover even if Malaya fell, the communists would not have the means to launch a land invasion of Australia but merely of sporadic air and submarine attacks.67 The Australian defence committee subsequently agreed that the loss of Malaya would mean that the enemy could establish bases there and possibly in Indonesia, but that because of their lack of naval strength, the communists would have great difficulty in launching a seaborne invasion of Australia. The committee concluded that British forces in Malaya were insufficient to meet a full scale Chinese invasion of Malaya and that if additional forces were not provided it would be necessary to abandon Malaya. But even if the Australians undertook to provide the necessary extra forces to defend Malaya, they would probably not be able to obtain the supplies from the British necessary to provide for those forces. And with the threat to Malaya unlikely to occur before ten months after the outbreak of war, the defence committee thought it militarily unsound for Australia to abandon the collective defence of the Middle East, in order to place a garrison in Malaya.68

66 Cablegram 3380 McBride to Menzies, 23 June 1951, CRS A1209/23 57/5229, AA.
67 Shinwell to McBride on defence discussions in June, 27 September 1951, CRS A5799 51/296 AA.
68 Defence committee agenda No 71/1951 on meeting of Commonwealth defence ministers London June 1951, Defence policy and global strategy, 12 November 1951, CRS A5799/1 51/296, AA.
McBride himself was dissatisfied with the United Kingdom's lack of commitment to the defence of Malaya. He reiterated that the decision to send Australian forces to Malaya or the Middle East depended on the wishes of the government in power at the time. In the meantime the Australian government had agreed to planning to send one division to the Middle East within three months of the outbreak of war, another division within twelve months, and a mobile air force task force of nine squadrons within three months. The Australian government had also approved the strength of its armed forces being built up to establishments required on mobilization. Moreover a national security resources board had been commissioned to advise the government on the proper balance between defence, immigration, national development plans, public and private investment programmes and the expansion of the civil economy. The board would advise on how to distribute manpower and materials between four broad sectors: the armed forces; munitions and supply; export supply (largely food and raw materials for the allies); and the civil economy on a war-time rationing basis.

The British were disappointed that the Australian government was only offering two divisions for the Middle East. At the last meeting of the defence ministers' conference, the British set targets for Middle East defence which they hoped the dominions would agree to. They wanted Australia to provide three and a third divisions within nine months of the outbreak of war and 166 aircraft by the beginning of 1953. Slim criticized the Australian government for awaiting the report of the national security resources board before committing itself to this target. He thought that unless there was a firm requirement on which to base defence planning, the result would be that the military effort in Australia would be curtailed to give rein to non-essential civil requirements. McBride replied that he could not possibly commit the Australian government to a target until the national security resources board had completed its report. He also qualified what the British hoped would be an agreed conclusion of the conference: that the threat to the Middle East in the next five years was more urgent and dangerous than the threat to Asia and the Pacific. Australia had,
he said, 'reservations in relation to certain supremely important problems which might arise in the event of a serious deterioration in the position of South East Asia.'

In August the national security resources board recommended that the government formally adopt the objective of providing for the material requirements of the forces that were to be raised on mobilization: a strength of 30,000 in the navy, 124,500 in the army, and 34,725 in the air force. This programme would cost about £400 million over the three years, 1950, 1951, and 1952. This was more than double what the Chifley government had estimated spending under the Dedman defence plan. Cabinet adopted the recommendation that, in view of the inflationary situation, an effort should be made to obtain a larger portion of defence equipment from the United States, the United Kingdom, and Canada. This would entail special negotiations at the highest level, in relation to the provision of equipment in the theatre of operations for Australian expeditionary forces, as well as the overseas procurement of supplies that had to be brought to Australia for training and home defence purposes.

Now that the national security resources board had produced its report, and that the government had taken the decision to allocate to defence the huge amount of money necessary to provide for the material requirements of the armed services on mobilization, the government could consider whether it could meet the United Kingdom's target for Middle East defence. On 11 November McBride submitted an agendum on this subject to cabinet. The defence committee had once again followed the British line and advised him that the current threat to the Middle East was a greater danger to the ultimate security of Australia than that which would arise from an attack on Malaya. It therefore recommended that the government commit itself to deploying in the Middle East the first army and air force contingents raised. Later forces would

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69 Cablegram 3384 McBride to Menzies, 25 June 1951, CRS A1209/23 57/5229, AA.
70 Cabinet decision 123 – 'Armed forces equipment programme – report of the national security resources board', 20 August 1951, CRS A4905/XM1 Volume 4 AA.
be deployed in the Middle East, Malaya, or the island chain to the north of Australia, depending on the government’s assessment of the strategic situation at the time.

Short of going on a complete war footing, the government should consider a number of changes to defence policy in order to meet the United Kingdom’s target for Middle East defence. First, the shortage of trained officers, non-commissioned officers, and specialists had to be rectified. Second, Australia had to be able to provide, at short notice, trained personnel in greater numbers. This could be done by extending the initial period of continuous service in the national service scheme from three to eighteen months, and forming a regular divisional group from national service personnel. The government would also have to establish a universal obligation for overseas service in peacetime. This would involve amending the defence act to provide for conscription for overseas service. Third, the government could establish an Australian brigade or division in the Middle East in peacetime. And fourth, there had to be an overall improvement in equipment and accommodation for the army. The defence committee also recommended a twenty per cent increase in aircraft establishment, an increase of ten per cent in the personnel of the regular air force, and an increase in the period of continuous service for air force national service trainees.

McBride submitted that the strategic disposition of Australia’s war effort should be concerted with the United States. He thought it quite possible that the United States might make military requests of Australia for cold war measures in Asia under ANZUS. Actually the purpose of ANZUS was to give Australia a general assurance of security which would stop her asking the United States for joint planning against communism in South East Asia.

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71 Cabinet agenda 174A — ’Australia’s capacity to provide forces for the Middle East in war, including measures to increase the preparedness of the forces’, CRS A462/2 439/1/1/17, AA.
an additional two and a third divisions ready to be sent to the Middle East within nine months of the outbreak of war, if the government decided to deploy the additional troops there, rather than in Malaya or in the island chain to the north of Australia. It also meant having five out of nine air force squadrons available for Middle East service, but to make a decision on the deployment of those forces after war had actually broken out. But the government decided not to lengthen the period of national service or to alter the defence act to provide for conscription for overseas service. 72

Later the defence department asked for permission to amend the air force commitment to make it clear that Australia would be firmly committed to sending nine squadrons at full establishment to the Middle East, as the first air force contingent raised. The wording of the original commitment left it open to the government to divert all the nine squadrons in this first air force task force, and not just later forces raised, to Malaya instead of the Middle East. Menzies wrote to McBride that

It seems to me that we should not lightly decide to develop plans for the defence of Malaya and the island chain to the north of Australia on the basis that 9 squadrons are irrevocably committed to the Middle East, but rather that we should have planning ready to use the whole of our external air strength in Malaya and the island chain should the strategic situation require this.73

McBride agreed with Menzies that the situation in South East Asia, particularly in Indochina, made it vital for the Australian government to ‘maintain flexibility in our position as suggested by you, until the relation between British Commonwealth and American policy and strategy is clear.’ He argued that it was urgent for the British Commonwealth and the United States to reach agreement on four important matters: the recognition of communist China and the position of the Nationalist regime; the action to be taken should massive Chinese air attacks be made on UN forces in Korea, with subsequent retaliation against air bases in Manchuria, causing an Asiatic or even a global war; the action to be taken should an armistice be concluded in Korea, but later

72 Cabinet decision 251, 4 December 1951, CRS A462/2 439/1/17, AA.
73 Menzies to McBride, 28 February 1952, CRS A462/2 439/1/17, AA.
broken by further communist aggression; and the action to be taken in the event of
direct intervention by the Chinese in French Indochina.74

A meeting of ministers briefing Menzies for his discussions with the Americans
and the British in the middle of 1952, reveals the extreme doubt of the Menzies
government about Australia’s place in western defence policy. The new minister for
external affairs, R.G. Casey, thought that the deterioration of the French position in
Indochina should make the government reconsider its commitment to the defence of
the Middle East. The meeting concluded that Menzies should impress upon the United
States government the necessity for global defence planning which included South East
Asia as well as western Europe and the Middle East. Menzies should tell the Americans
that if they wanted an Australian contribution to the western war effort against
communism, the prerequisites would be including plans for the defence of South East
Asia in global strategy, and assistance with the supply of equipment to Australian
combat troops.75

The Americans did not agree to this. The department of state argued on 29
December 1951 that New Zealand and Australia should rest content with the security
guarantee under ANZUS and commit their forces to the defence of the Middle East. It
did not want the Pacific pact to develop into a regional security system with regard to
South East Asia, because the United States government was not prepared to commit
ground troops to the defence of South East Asia and ‘paper security agreements not
backed by commitment of forces were worse than none at all.’76

On his visit to Washington in May 1952 Menzies requested access for Australia to
NATO planning. He also expressed concern about the situation in Indochina,
suggesting that its loss would entail the loss to communism of the whole of South East

74 Ibid., McBride to Menzies, 4 March 1952.
75 Minutes of meeting held on 7 June 1952 – briefs for the prime minister’s visit abroad, CRS A1209/23
57/5055 AA.
76 ‘The military role of Australia and New Zealand’, position paper of the department of state, 29
Asia. If Indochina were lost, the Australian people would not permit the despatch of troops to the Middle East. In reply, Acheson stressed that the Australian belief that NATO was engaged in global planning was based on a fundamental misconception. NATO dealt solely with the defence of Europe. He added that the United States would not commit herself to the defence of South East Asia. 77 Acheson later commented that 'the Australians' most cherished idea, to have a direct and permanent relationship between their chiefs of staff and ours, was already developing into a serious and embarrassing problem.' 78 The American joint chiefs of staff would only recommend that

in the event that the Chinese communists do attack [South East Asia], despite our every effort to prevent it, the US will make such a contribution as is possible, in the light of its world commitments, to the defence of South East Asia except for the deployment to the area of American ground forces. It may, however, become necessary to take air and naval action against communist China itself, such as a blockade and attack against selected targets. 79

This was just what the Australians did not want: no commitment of American ground forces to South East Asia and a futile and provocative blockade and bombing attack against communist China.

Conclusion

The federal election in 1949 was an important turning point in Australian history. The 1949 election began a transition from a Labor government concerned to prepare for depression to a Liberal–Country party government resolved on preparing for war. The Chifley government was optimistic that another world war would not break out. Its foreign policy rested on support for the United Nations and on internationalism. Its defence policy was a long term plan based on the principle that Australia would play its role in collective and Commonwealth security in the Pacific. The Labor government

78 Pemberton, op. cit., p.31.
saw the threat to Australia’s security coming not from communist aggression in Europe, but from either a resurgent Japan or from Chinese aggression in South East Asia. Evatt strove for some sort of regional security arrangement, backed by the United States, against the possibility of Japanese aggression. And his government also wanted to forestall possible Chinese expansion in South East Asia. But importantly it did not want to combat communism in Asia militarily; rather communism could best be fought through a programme for the economic reconstruction of South East Asia.

This all changed with Labor’s defeat in 1949. The new government was not driven by the same obsession about depression, but it had grave fears that war would break out again. It saw its foremost task as making Australia a partner in the western alliance which was being formed by the United States and the western European countries to combat the perceived threat of international communism. It saw communist aggression in Europe, the Middle East, and South East Asia, as threats to Australian security. While there would not be a direct threat to Australia itself, the Menzies government thought that communism had to be fought in the areas where aggression occurred. Menzies considered that this would probably be in the Middle East and agreed to plan for the defence of that area with the United Kingdom government in June 1950. Spender, on the other hand, stressed that there was also a danger of war in Asia. After war broke out in Korea, the Australian government eventually agreed to send combat troops in order to forge a closer alliance with the United States – an alliance which would protect Australia from the threat of Asian communism in Asia. In its first budget the government increased defence expenditure to meet the threat of war. It introduced national service and changed the conditions of service in the army so as to be able to meet future military commitments to the United Kingdom.

Menzies returned from the Commonwealth prime ministers’ conference of 1951 anxious about the situation in the Far East, but even more worried that Korea was a diversion to cover a planned assault by the Soviet Union on western Europe. He
returned to announce the danger of war in three years. Chifley, on behalf of the Labor
opposition, countered that war with the Soviet Union and China could be avoided, and
that even if war broke out, Australia’s own borders were safe. He thought that
expensive defence preparations designed to meet a commitment to the Middle East
were wasteful and unnecessary. All the evidence leads to the conclusion that a Labor
government would not have made a military commitment to the Middle East and would
not have conducted its foreign, defence and economic policies on the assumption that
war with the Soviet Union was likely.

Meanwhile Australian and American interests converged to produce a Pacific
pact in 1951. What the Australian government wanted out of the pact was access to
American global defence planning so as to ensure that, if there was a global war,
Australian interests in the Pacific would be protected. What the Americans gave
Australia was a vague assurance of security in a treaty which was designed to avoid the
necessity for joint Australian–American planning against communist aggression in
South East Asia, and which was designed to make Australia more willing to commit
herself to the defence of the Middle East. The Australian government made a
commitment to the defence of the Middle East in December 1951, but remained
extremely anxious about the trend of events in South East Asia. The United States
remained unwilling to commit itself to defending Indochina and completely
uninterested in making a commitment to protect Malaya – a colonial dependency of the
United Kingdom. Moreover, with commitments in the Middle East, the British could
not promise to protect Malaya. Menzies’ policy of preparing Australia for war so as to
gain the approval of his powerful allies – the United Kingdom and the United States –
still left a great cloud over Australia’s own security. But to have revealed this doubt to
the Australian public would have gone a long way to confirming the wisdom of
Chifley’s foreign policy: limiting Australia’s defence expenditure, holding off from
making military commitments in the Middle East and Asia, and preserving a role for
Australia, if global war broke out, of a largely non-combatant supplier of the western allies with food and raw materials.
CHAPTER SIX - NATIONAL DEVELOPMENT AND ANTI- COMMUNISM

In this chapter I examine the Menzies' government's domestic economic and anti-communist programme. The Labor government's policy of economic security involved relatively low defence spending, government controls, reliance on Australian and British capital for investment, and support for sterling area economic policies. The Menzies government emphasised the need for Australia to prepare for war and to accommodate itself to the strategic plans of the United Kingdom and the United States. Domestically, Menzies pursued a policy of national development: increased defence expenditure, and public and private investment. Simultaneously it pursued a vigorous anti-communist policy with the aim of increasing production and speeding up defence preparations by removing communists from positions of influence in the trade unions.

In February 1950, the cabinet committee on economic policy reported to cabinet on the general economic situation. Prices, it said, had been rising at a rate of ten per cent per annum since 1947 due to high incomes in the Australian community, large monetary reserves, and large public and private investment programmes. The Chifley government had tried to fight inflation by subsidizing certain basic goods, particularly those which affected the "C" series consumer price index – the index by which the basic wage was adjusted. The committee was sceptical about the benefits of a subsidy policy:

In general price stabilization subsidies treat of the symptoms of inflation and not the basic causes. Cost increases are disguised by a budgetary appropriation which might easily exceed £100 million within a year. Unless the subsidy bill were covered by heavier taxation, the effect would be positively inflationary...

The committee agreed that a subsidy scheme would be ineffective without the wide range of wartime controls over wages, consumption, production, and distribution, which had been phased out because of political and constitutional difficulties. Full cabinet endorsed the conclusion of the economic policy committee that the general
extension of subsidy payments was not a satisfactory solution to arresting the rise of the cost of living.¹

H.C. Coombs, now governor of the Commonwealth bank, prepared a report in May comparing the economic policy of the Chifley government with the new policy directions of the Menzies government. Coombs explained that at the end of the war, the Labor government had envisaged that there would be a boom lasting two or three years, during which time wartime arrears of demand and high prices overseas for Australian primary products would ensure full employment. After the boom there would be a recession in which domestic and overseas demand would fall. With these expectations, the Labor government had decided upon a policy of restraining the postwar boom so as to avoid developments which weakened Australia's capacity to adjust to the subsequent depression. It hoped to prepare for depression by building up international reserves, and by establishing a programme of investment which could be sustained in the face of declining conditions abroad. Public investment would be restrained and private investment controlled through capital issues and banking controls, so that the level of total investment, adjusted to maintain full employment, "would be such as could be carried out without radical change and without direct overseas borrowing". In the meantime, budget surpluses, stabilization funds for primary products, and banking policy would restrain the pressure of demand on available supplies.

But now, said Coombs, Chifley's economic policy had to be reviewed. The expected recession had not come, and a detailed programme of economic controls had to be written off as "largely ineffective, impracticable or unacceptable for other political reasons". Moreover the Menzies government placed greater emphasis on development and less on economic stability, and introduced a new factor in the policy of putting value back into the pound. Coombs warned, however, that the coalition's

¹ Cabinet agendum 48, 20 February 1950, Fourth Menzies ministry cabinet agenda, CRS A4639/XM1, AA.
policy of unrestricted development and appreciation of the Australian pound 'would necessarily conflict with the goal of stability'. The Australian economy would become extremely vulnerable to a depression, if one came, and for the economy to keep functioning at full employment the government would need to borrow and get high prices for Australian goods overseas. 2 2

Trevor Swan, now in the prime minister's department advising Menzies, argued even more strongly that

Without a substantial appreciation there is no real hope of any reduction in the price level in the near future. Even drastic measures to curtail demand, including the virtual abandonment of the immigration programme, would succeed in bringing down prices only if it were possible by creating unemployment to enforce an actual reduction in real wages.3

On 12 May the cabinet committee on economic policy requested a report from the treasury to examine the effects of the new government’s economic policy. The committee at this stage ruled out appreciation of the Australian pound, and large dollar borrowing, but favoured tax reductions. The report was to be prepared on the assumptions that there would be a depreciated currency which inhibited imports, a tariff policy designed to keep out imports once they started to compete with Australian goods, no access to dollar goods beyond their existing level, and reduced rates of taxation stimulating demand. The report was asked to discuss 'the inflationary process that may result, and in turn the effect which this inflationary process may have on the achievement of the migration and development programmes'.4

The treasury prepared a report on what was likely to happen in Australia if the migration and development programmes continued and if the government did not attempt to influence the course of events by raising the interest rate, lowering the tariff, maintaining taxation, or lengthening working hours. The report concluded that there would be further inflation, limited improvement in productivity, and a continuation of unproductive investment in non-essential areas rather than in basic

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3 'Anatomy of inflation', by T.W. Swan, 3 April 1950, CRS A571 50/1003 Part 1, AA.
4 Ibid., request for report by cabinet economic committee, 12 May 1950.
industries like coal and steel. Treasury argued that the fulfillment of the government’s policy objective required two things: first, the reduction of investment demand and the increase of supplies at ruling prices; and secondly, a change in the composition of investment so that basic requirements such as building, construction, and power, were adequately met. Some treasury officers, including F.H. Wheeler, supported the former government’s policy and argued against the policy of borrowing overseas to finance a huge import surplus ‘because we would become more vulnerable, both because of the changed structure of industry, and because of not being able to go on borrowing. Our aim should be to remain as self sufficient as possible.’ Other officials, like Randall of treasury and Swan of prime minister’s, had more faith in the economy’s flexibility, and stressed that in any case, a policy of expanded development was ministerial fiat and not a subject for debate by bureaucrats.\(^5\)

In March 1950 the government deliberated on how to implement the other main part of its domestic policy – the anti-communist programme. The minister for labour and national service, Harold Holt, prepared a cabinet memorandum on the subject for his colleagues. He wrote

> the question now arises for determination whether industrial stability and cooperation will be served by the proposals indicated in the policy speech or whether some modification of the proposals is desirable in the light of intervening developments and present knowledge.

Holt thought that because public opinion was overwhelmingly in favour of banning the Communist party, a bill to outlaw the Communist party should go ahead. However he had reservations about two other aspects of anti-communist policy: mandating secret ballots before strikes and before the election of union officials; and banning communists from trade union positions. He argued that the first policy was unacceptable to the ACTU and that Labor’s legislation, in which provision had been made for legal challenges to irregularly conducted union elections, might yet prove both adequate and effective. He urged cabinet to defer the immediate implementation

\(^5\) ‘Some notes on economic prospects’, 23 May 1950, CRS A571 50/1003 Part 1 AA.
of a provision for compulsory secret ballots before strikes, but to draft a bill to be ‘kept on ice... until an industrial crisis giving a favourable atmosphere for its passing develops.’

The second proposal to which Holt objected was the banning of communists from trade union office. In his view, that policy would create an alliance between ‘moderate’ trade unionists who feared similar repressive legislation against themselves and the communists. Moreover he had doubts about how far the legislation should be extended – to shop stewards as well as to general secretaries? He referred to the danger of unions affected by the legislation transferring to state jurisdictions, deregistering, or relying on collective bargaining. He pointed to the difficulties involved in drafting the legislation and to the need for government–union cooperation on larger matters of policy. His recommendations to cabinet were threefold: to make the token gesture of banning the Australian Communist party; to defer the decision on compulsory secret ballots before strikes; and to renege on the election commitment to ban communists from official positions in trade unions.

After a vigorous debate, cabinet agreed to defer introducing legislation about union ballots but rejected Holt’s recommendation to refrain from removing communists from trade union positions. The reason why the government took this momentous decision can be found in the view that a third world war against international communism was thought imminent. As Menzies put it

If communism is just militant unionism, opposed to arbitration but determined to alter the law by lawful means, no punitive action against communism can be justified. But if communism is an international conspiracy against the democracies, organised as a prelude to war and operating as a fifth column in advance of hostilities, and if it is a subversive movement challenging law, self–government and domestic peace, the alleged immunity of the union official or any other body is utter fantasy.

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7 Cabinet agendum 61.

This is not to ignore that Menzies fully appreciated the political damage which a proposal to remove union officials by statute would do to the Labor opposition. Menzies wrote to Harrison on 6 May that he could hardly believe his eyes when he saw that the Labor party was ‘prepared to accept the removal of a union official under an act of parliament in any form at all.’ He was extremely pleased that the Labor party had been forced by public pressure to acquiesce in this measure and looked forward to the making of a ‘first class split’ in the ranks of the opposition. ⁹

Menzies introduced the communist party dissolution bill in the house of representatives on 27 April. The preamble of the bill contained recitals arguing that communism was designed to accelerate a revolutionary situation; that communists were part of a worldwide organisation which engaged in treasonable and subversive activities; that certain industries were vital to the defence and security of the Commonwealth; that the activities of the Australian Communist party were designed to dislocate those industries as a prelude to war; and that the Commonwealth was empowered to ban the Communist party under the defence power. The bill declared the Communist party unlawful and dissolved it. Organisations affiliated to, associated with, or influenced by the Communist party could be dissolved as long as the government was satisfied that their activities were prejudicial to the Commonwealth. With some lack of consistency, Menzies commented: ‘we are not going to suggest that a trade union should be dissolved because its management committee happens to have a majority of communists on it. A trade union is of itself a legitimate organisation and therefore is excluded from the process’. Any declared organisation would have the right of appeal to the high court, but the onus of proof would be on the declared body to show that it was not a ‘communist’ organisation. Similarly, any member of an outlawed organisation whose activities the government deemed dangerous could be declared. The onus of proof would be on the declared person to prove he was not a

⁹ Menzies to Harrison, 6 May 1950, Menzies Papers, MS 4936 Series 1, Box 14, folio 119, National Library of Australia (NLA).
‘communist’. If the declared person failed to satisfy the courts, he could be removed from agencies of the Commonwealth or from positions in trade unions.10

The Labor opposition, which because of its majority in the senate, had the power to reject the bill, decided to agree to the second reading of the communist party dissolution bill, but to amend it in committee. The thrust of Labor’s argument, as outlined by Evatt, was that the bill brought within its net not only communists but also non–communists, without giving them the benefit of the due process of law. Referring to clause five of the bill which outlawed organisations affiliated to the Communist party, Evatt argued: ‘so far as individuals are concerned, they need not be associated at all with communism, indeed non–communists may be the majority of such an organisation.’11 As long as the government was satisfied that the activities of such a body were prejudicial to the security of the Commonwealth, it could be declared. Similarly clause nine of the bill allowed the government to declare any individual, as long as he or she was a member of an unlawful association, simply on the grounds that he was ‘likely’ to engage in activities prejudicial to the laws of the Commonwealth. Evatt pointed out that this was not a question of onus of proof: ‘this bill provides that every trade union secretary, whether he be a communist or not, can be thrust out of office at the will of the government without being told what is alleged against him, provided he is a member of one of the affiliated organisations to which clause five relates’. And though the reason for someone’s declaration might cover a wide field, appeals would be limited to the question of membership of the Communist party or of an associated organisation, and not the reason why the government thought him dangerous.12

In the committee stage Evatt moved amendments which sought to place the onus on the Commonwealth to prove that both individuals and bodies associated with the

11 Ibid., pp.2289-90.
12 Ibid., pp.2290-1.
Communist party were not only 'communist' but also that their activities were prejudicial to the safety of the Commonwealth. Menzies refused to agree to the amendments on the grounds that information of the security services would have to appear before the courts. If Labor's amendments passed, argued Menzies, the law would become a dead letter. 13 He did however change the bill so as to prevent individuals being declared unless they were actually members of the Communist party. An individual could no longer be declared if he belonged merely to an organisation 'associated' with the Communist party. Another major government amendment provided that if declared individuals or the officials of declared organisations were prepared to go into the witness box to be sworn, the onus would be on the crown to prove that they were 'communists'. These amendments did much for Menzies' case that only communists would be affected by the bill. The Age and the Argus were the only papers which supported Labor's campaign against the bill. And now the Age called for its passing, arguing that the government had gone as far as it could in trying to meet the objections of those who objected to the bill on grounds of civil liberty. The Labor opposition held firm and insisted on its amendment, arguing that the government should have to prove not only that declared individuals or organisations were 'communist', but also that their activities were prejudicial to the laws of the Commonwealth. 14

The senate insisted on amending the bill and the government bided its time before re-submitting the bill to it after an interval of three months. If the bill were rejected a second time, Menzies could ask for a double dissolution. In the meantime, the government prepared its first budget. The expenditure estimates for 1950/1 showed a marked increase over the previous year's. The estimated increase over the Commonwealth's expenditure of £738 million in 1949/50 was £170 million. This

13 'Notes on the Labor Party's amendments to the anti-communist legislation', n.d. and 'Further evidence of the design of the opposition's amendments to kill the bill', Menzies Papers, MS 4936, Series 20, Box 436, folder 1, National Library of Australia (NLA).
14 Age, 2 September 1950.
massive increase occurred despite treasurer Arthur Fadden's aim to keep overall expenditure estimates not far above the level of actual expenditure in 1949/50.'15 Almost half of the increase in Commonwealth spending was due to higher defence spending. Other major items of expenditure increase were a war gratuity payment, a subsidy of £20 million on woollen goods, and expanded social service payments.16 The government was also required to fulfill its electoral promise to grant child endowment to the first child in every family, at a cost of £46 million in the first year. And in May, cabinet decided that although it had no electoral obligation to increase pensions, pension increases were a political necessity given that pensioners alone represented twelve per cent of the voting population. War and service pensions, age and invalid pensions, and widows' pensions were raised at a total cost of £12 million.17

The government had to devise some means of financing this increased expenditure without fuelling inflation. Aside from this, it had to deal with the highly inflated incomes of exporters derived principally from the sale of wool to overseas buyers. The governor of the Commonwealth bank registered his concern at budget prospects on 11 August. He argued that financing the deficit by treasury bills would add to the money supply, add to the net flow of income in the community, and increase the government's debt to the central bank.18 But after the promises of lower taxation in the 1949 election, and with the prospect of a double dissolution before the end of the year, a tough budget with higher taxes was inexpedient. Instead of adopting higher taxation generally, the government decided to tax the inflated wool cheque and to use the extra revenue gained to finance increased Commonwealth expenditure.19 The government would justify this sectional tax on the grounds that war fears had caused

15 Cabinet agendum 132, 1 July 1950, fourth Menzies ministry cabinet agenda, CRS A4639/XM Vol 6 AA.
16 Ibid.
17 Cabinet agendum 116, n.d. May 1950, fourth Menzies ministry cabinet agenda, CRS A4639/XM Vol 5 AA.
18 'Budget prospects', governor of the Commonwealth bank to treasurer, 11 August 1950, CRS A571 50/1677 AA.
19 'Wool tax - notes by Dr Wilson', n.d. August 1950, CRS A571 50/1677 AA.
the rise in wool prices just as they had caused the necessity for increased expenditure on defence preparations. The rationale of the tax would be that it was an anti-inflationary measure. However Roland Wilson of treasury warned:

the anti-inflation argument can only be sustained if it can be made to appear that the government is withholding the proceeds of the tax – or if the main part of the tax is transferred to trust accounts. It will not be served, and the contrary argument would gain support, if the proceeds of the tax or a large part of it appears to remain in consolidated revenue to finance general expenditure.20

The government refused to heed this advice, and decided to use £103 million of the wool tax as general revenue. Fadden found, however, that this would put the budget into surplus. This was a politically undesirable result because the press and the state governments would claim that, with the budget in surplus, the Commonwealth’s revenue was buoyant enough to grant further substantial tax reductions, and higher grants to the states. 21 So the government simply transferred its war gratuity payments to general revenue instead of the loan fund. This put the budget back into deficit.

On 13 September cabinet decided to impose an excise tax of thirty per cent on wool sold since the beginning of the wool sales. But it could not agree on another major aspect of anti-inflation policy – appreciation. The appreciation of the Australian pound would have made imports cheaper and exports dearer. It would have helped the Australian economy to import more and to soak up the excess demand which was driving prices upward. Historians have tended to focus on divisions in the Labor party after 1950. What has escaped notice is the bitter disputes in the coalition ranks – disputes which sometimes threatened the existence of the government. One such dispute was the wrangling over appreciation. Menzies and most of his Liberal cabinet colleagues favoured appreciation as a major step in the battle against inflation. Fadden and his Country party colleagues, on the other hand, thought that appreciation was unnecessary because the big rise in wool prices would only be temporary. They had to

21 'Budget discussions with treasurer', 23 and 24 September 1950, CRS A571 50/1677, AA.
represent the interests of their constituents. The Country party therefore rejected both
the export tax on wool and appreciation, telling their ministers that if the plans went
ahead they should part company with their Liberal colleagues. 22 In the Liberal party,
R.G. Casey was one minister who urged a split with the Country party on the issue.23
In the end, on 30 September, Fadden and Menzies reached a compromise: the
government put to their parties a modified wool proposal in which woolgrowers’
incomes would be taxed as a prepayment for future taxation. Appreciation was
abandoned.

The Sydney Morning Herald immediately pointed out the weaknesses of Fadden’s
budget. On 13 October the Herald said that although the treasurer had shown
commendable determination to avoid deficit financing by treasury bills, ‘an increase of
£172 million cannot fail to be inflationary however financed.’ 24 Its financial
 correspondent argued that the wool tax was a forced loan, not revenue, and that while
the government was reducing the woolgrowers’ income by £103 million, the money
was being spent immediately by the government. He went on to argue that the budget,
while showing a small nominal surplus, would add rather more than £30 million to the
amount of money in circulation, when adjusted for payment and withdrawal from trust
funds. By contrast, Chifley’s last budget had reduced the amount of money in
circulation by £30 million.25 In his reply to the budget on 24 October, Chifley
criticized not the government’s failure to put value back into the pound, but rather the
fact that it had made an election promise that it was manifestly unable to keep. He
repeated the Herald’s criticism that the wool tax was a ‘cash receipt in the form of a
forced loan’ and argued that spending the proceeds of the tax in 1950/1 would in fact be
more inflationary than if it were left in the hands of the woolgrowers. This was
because the government was going to spend the entire proceeds of the tax whereas the

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22 Arthur Fadden, They Called Me Artie - the Memoirs of Arthur Fadden, Brisbane, 1969, pp.115-16.
24 SMH, 13 October 1950.
25 SMH, 15 October 1950.
woolgrowers would have saved some of their income. Chifley rejected appreciation because of the detrimental effect it would have on Australia’s mining and primary industries, and criticized Menzies’ dollar borrowing. But fundamentally, he objected to Fadden’s first budget because of the huge increase in defence expenditure.26 Menzies replied that if the government did not tax the woolgrowers by £100 million, it would be doubly inflationary because the treasurer would have to finance a deficit of £100 million by discounting treasury bills. For Menzies the issue was not who spent the £100 million, the government or the woolgrowers. The question was: would the £100 million be taxed and spent once by the government, or would it be spent both by the woolgrowers, if it were left in their hands, and by the government in financing its deficit?27

In December the government created a national security resources board to advise it. In his opening statement to the board on 18 December, Menzies said that until recently it had been possible to contemplate the development and immigration programmes as the principal national objectives. But the international situation had deteriorated so markedly that the government had established the national security resources board to advise it on how to ‘superimpose an expansion of the immediate and prospective defence programmes on an economy already bearing the strain of ambitious programmes of development and immigration.’ Menzies argued that the situation in 1950 was different from the second world war, in which there was a declaration of war followed by a period of progressive preparations:

we were much more likely to be faced by a period in which we were not yet at war, but were clearly not at peace – a period of mounting international tension relieved by intervals of deceptive calm which reassured nobody while the fundamental causes of international tension persisted. Unless, therefore, there was a change in Soviet policy, the best prospect we could hope for was to live through difficult years marked by a continuous alert,

and in these years we should have to strengthen our defences and make all necessary defence preparations to meet a supreme crisis. 28

Accordingly, said Menzies, the government had set up the board to advise it on how to rebalance the economy in the civil and defence fields. It would give advice on the relative priorities to be accorded to the various national tasks, on the establishment of a proper balance between defence commitments, immigration and national development plans, and private investment plans, and on the expansion of the civil economy. If the government thought that war was unavoidable, he continued, it would have to abandon the long range immigration and development programmes, and sacrifice public works and private investment programmes to make way for urgent defence projects. But the government did not regard a war as completely unavoidable. It did not regard the efforts to maintain world peace as destined to fail. It was the government's responsibility, therefore, to strike a balance between short run defence preparations for a future mobilization if that should be necessary, and long range development. Its decisions would be based on an appreciation of the whole situation, including the international outlook, the probable strategic role of Australia in a future war, the technical and military problems of defence, and the conditions of development and economic expansion. The national security resources board would function as a centralist consultative body to advise the government on the whole problem of budgeting the requirements for defence and development against the nation's resources and to review the structure of the plans for economic mobilization that would be necessary in the event of war. Menzies said that the government was reluctant to impose administrative controls in time of peace, and that the objective should be 'order without orders.' The board included public servants, economists, representatives of industry, and trade unionists: G.T. Chippindall, a senior public servant, H.C. Coombs, governor of the Commonwealth bank, W.E. Dunk, chairman of the Commonwealth public service board, J.R. Kemp, coordinator-general of public works, I.M.

28 National security resources board - minutes of the first meeting of the board, 18 December 1950, fourth Menzies ministry cabinet agenda, CRS A4639/XM1 Volume 7, AA.
McLennan, an industrialist, Frederick Shedden, secretary of the department of defence, A.V. Smith, a public servant, R.J. Vicars, a banker, R.C. Wilson, a senior treasury official, A.E. Monk, a trade unionist, and E.R. Walker, an economist. 29

Contrary to Menzies' expressed intention of avoiding administrative controls in peacetime, cabinet on 4 December decided to re-establish control over capital issues through an investment board. At the same time, the national security resources board decided to submit to the government proposals relating to the need for a broader policy for the rationalization of public and private investment, of which capital issues control would be only one of the instruments. The board pointed out that the effort to expand industrial capacity and public works within Australia had outrun the ability of firms to obtain labour and materials and get work done within a reasonable time. This had two unfortunate results: first, government and business plans of great importance to meeting defence needs and ensuring the balanced development of the Australian economy were continually being thwarted by competition from other less valuable projects; and second, the persistent competition for a quantity of labour and materials which could never satisfy demand, inevitably drove up costs, incomes and prices. The board argued that the objective of national policy should therefore be to relieve inflationary pressures and at the same time ensure that labour and materials found their way to priority tasks. To do this capital issues should be used in conjunction with the rationalization of the public works programme and the strict control of bank advances. Capital issues control would be brought back under the transitional defence power, but this time not under the power 'to bring a gradual and orderly transition from war to conditions of peace'. In December 1950, parliament gave new life to the regulations by amending the defence (transitional provisions) act to include 'the further purpose of

29 Ibid.
assisting to meet the increasing defence requirements and commitments of Australia as a member of the British Commonwealth and of the United Nations.30

Meanwhile in October 1950, with the government looking likely to use the senate's rejection of the popular anti-communist bill as grounds for a double dissolution, many in the Labor party began to fear an electoral rout. On 16 October the federal executive of the Labor party caved in and directed the federal parliamentarians to let the bill through.31 Shortly afterwards Evatt agreed to represent the Waterside Workers' Federation in a challenge to the legislation in the high court. This was a typically impetuous decision, taken without consultation with Chifley. Essentially what the high court was asked to decide was whether the Commonwealth could ban the Communist party under the defence power in a period of 'cold war' and whether the federal government could be given absolute discretion to decide what was required for national security and what groups were prejudicial to it.32 The solicitor-general, K.H. Bailey, asked the department of external affairs for material which tended to establish, as a reasonable inference from the facts, the existence of a 'cold war'.33 The government's legal strategy was to prove to the high court the existence of a 'cold war' which would allow the Commonwealth to adopt extraordinary measures under the defence power. This contrasted with Labor government's legal strategy which was to prove the existence of a 'dollar shortage' created by the war which legitimized the Commonwealth's use of extra-ordinary economic powers. External affairs responded by making a case that Australia was involved in the diplomatic, economic and political struggle known as the 'cold war'. It argued that there had been a growth of tension between the Soviet Union and the western powers, particularly since the adjournment of the council of foreign ministers in December 1947. That tension had been

30 Cabinet agendum 226A, 'Capital issues control and the rationalisation of investment', 23 January 1951, Fourth Menzies ministry cabinet agenda, CRS A4639/XM1 Volume 7 AA.
31 Crisp, op. cit., p.395.
32 Brian Galligan, Politics of the High Court, Queensland University Press, 1986.
33 'Message from Watt', 25 October 1950, CRS A1838/1 88/1/2 AA.
characterized by the failure to reach agreement on peace treaties with Germany and Japan. The most serious tension during 1947 to 1949 was in connection with Germany, particularly Berlin, where the Australian government took action to support the position of the western powers by sending air force personnel to participate in the airlift. In May 1949 the Australian government had publicly supported the regional arrangement for the North Atlantic, arguing that this was necessary because the United Nations had not yet established collective security. And finally the Australian government had participated in the collective defence effort against communist aggression in Korea. 34 Ironically external affairs made a case for Australia’s involvement in the ‘cold war’ when in reality the Chifley government had been endeavouring to preserve an independent stance in the struggle between the Soviet Union and the western powers and to deny the likelihood of global war. Evatt’s legal argument on behalf of the Waterside Workers' Federation was that the legislation was unconstitutional because it was not a law with respect to the defence of the Commonwealth, nor with respect to matters incidental to the executive power of the Commonwealth. It was a law about the opinion of the executive that certain groups and individuals were prejudicial to Australia’s security. 35

During the course of the argument, chief justice Latham wrote down some observations for the benefit of his brother judges. He argued that it would be impossible for a court to decide whether an organisation was traitorous or whether fifth column activities were actually going on. This was because the evidence submitted would be suspicion, hearsay, and reports of security officers. He further argued that a determination by the court whether national security demanded the banning of the Communist party, would not be decided by a scrutiny of objective facts, but by the ‘political opinions of the judges themselves’. And since the court must have no political

34 Ibid., 'Australia and the "Cold War"', 25 October 1950.
opinion, he submitted that the high court should leave the matter of the dissolution of the Communist party to parliament and the executive. He concluded:

The arguments of the plaintiffs naturally disregard all such considerations. The decision was given against them in the government and the parliament, and they therefore in an endeavour to upset that decision, exalt the functions of the court in what I suppose is regarded as a prudent form of flattery. 36

But the prudent flattery seemed to work. The majority of the court, Latham dissenting, found that the act was ultra–vires the constitution. As Galligan has observed, the court objected to leaving the decision whether an organisation was unlawful to the executive. A wistful appraisal of the high court judgement, submitted to cabinet, concluded:

It is impossible to resist the conclusion that what tipped the scale with the majority was the fact that the act made unexaminable by the court, parliament’s own opinion that the actual existence of the Communist party was itself prejudicial to defence, and the opinion of the governor– general that other organisations were in like case and that individuals were or were likely to be engaging in activities prejudicial to defence. 37

Ironically, the communist party dissolution act might have satisfied the high court if Menzies had accepted Evatt’s amendments to the bill in the committee stage.

On 12 March cabinet considered its options. One view was that the communists could be fought effectively by the crimes act and a defence preparations act. Another was that the Commonwealth should seek to have power over communism delegated by the states. After a vigorous debate, cabinet decided to have a referendum on the issue of communism. But more importantly, it decided to have an election immediately. The reason for this was not so much that the government regarded the communist party dissolution act as vital to its legislative programme, but that with inflation rapidly increasing, and with Labor in control of the senate, the opposition might force Menzies to an election later in his term on the issue of his failure to put value back into the

36 ‘Communist party dissolution case’, 11 January 1951, Latham Papers, MS 1009, Series 62, items 931-63 NLA.
37 Cabinet agendum 161F ‘Appraisal of high court judgement’, fourth Menzies ministry cabinet agenda, 14 March 1951, CRS A4639/XM AA.
pound. Menzies wanted to fight the election in April 1951 on the issue of the need to prepare for war against communism abroad and at home. As was pointed out in the previous chapter, Menzies did not fear a direct attack on Australia. His fear was of a global war in which the Soviet Union invaded western Europe and the Middle East, while China launched an attack southwards. He regarded Australia’s participation in the western war effort as essential to Australia’s long term security, especially if Australian diplomacy secured an American military commitment to the defence of South East Asia. Menzies wanted, therefore, to reverse Labor’s independent stand on foreign policy and to secure public acceptance of the need for Australia to play out the military role devised for it in the strategic plans, which hopefully would be concerted with the British Commonwealth and the United States. Labor, on the other hand, wanted to remain aloof from those plans, to and to keep defence spending low.

Cabinet decided to bring forward a bill on compulsory secret ballots for union elections. Labor would then face the dilemma of either letting the bill go through and offending the ACTU, or opposing another measure in the government’s popular programme against communism. To provide more ammunition for a double dissolution, cabinet resolved to place the Commonwealth bank bill, opposed by Chifley, to the head of the senate notice paper. 38

The Labor opposition hoped to get around its dilemma by referring the Commonwealth bank bill to a senate select committee and not explicitly rejecting the bill a second time. But the governor—general, on the advice of Menzies, granted the government a double dissolution on the ground that the bill had failed to pass. On 27 March, Chifley made an election speech which he would have preferred to be making a year or two later, claiming that: ‘the one and only problem is to arrest the runaway Menzies pound and place it under restraint.’ He promised that he would put to the people another referendum on prices and profits. Wages would not be directly controlled but a Labor government would negotiate wage restraint and increased

38 Ibid.
production with the unions. He also promised that a Labor government would not allow resources to be diverted for defence purposes, away from developmental projects which added to the strength of the national manufacturing and rural industries. But alongside these policies were promises to increase child endowment and pensions, and to refund the wool tax – promises which would have to be financed somehow. He did not foreshadow tax increases, but he hinted that spending on defence and immigration would be reviewed. And finally, he stated bluntly that Menzies’ anti-communist programme was not a remedy against inflation: ‘Mr Menzies deliberately confuses the issue for you by distorting the relationship between subversive activities and the general economic problems which he has completely failed to tackle.’ 39 In contrast to Chifley’s economic programme, Menzies adhered to the transcendent need to increase production by removing communists from key positions in trade unions. He promised also to reintroduce capital issues controls, in order to encourage essential rather than luxury goods, under a defence preparations act. 40

The relative merits of the parties’ economic programmes became the subject of much press discussion. The Age wondered how Labor’s promises would be financed and concluded that ‘on present signs electors can best conclude that Labor’s plans would involve a substantial increase in taxation’. 41 On 29 March the Sydney Morning Herald criticized Labor’s seeking control over prices without a simultaneous control over wages. 42 And the next day the Herald commented that ‘whatever the internal causes of inflationary pressure – and the most virulent seeds were sown during Mr Chifley’s long regime – defence expenditure promises to be the main contributor in the life of the next parliament’. 43 The paper argued that Labor did not have any plans for financing the necessary increase in defence expenditure without fuelling inflation. In

39 SMH, 28 March 1951.
40 Age, 4 April 1950.
41 Age, 30 March 1951.
42 SMH, 29 March 1951.
43 SMH, 30 March 1951.
fact Labor's strategy was to stick with a very limited defence budget. Because of Menzies' tactical victory in the timing of the election, Chifley did not do as well as he anticipated. Labor anticipated a gain of ten to twelve seats in the house of representatives, but won only five seats back from its opponents. Four of these were country seats affected by the wool levy. Large coalition majorities in Western Australia and Queensland also gave Menzies control of the senate.

Menzies' election win in 1951 was a stroke of great fortune. To have left Labor with a majority in the senate and hence with the ability to reject the 1951 budget and other legislation, would have been extremely dangerous, especially since inflation reached its peak in the months after the election. In a cabinet memorandum of July 1951, Fadden pointed out that during most of 1950, Australian prices had been rising rapidly, but at about the same rate as under the Chifley government. But towards the end of 1950, the situation changed dramatically for the worse. Fadden produced a table showing that the rate of inflation in 1951 was about double what it had been in the previous years.

Table 6.1 – Retail Price "C" Series Index

<table>
<thead>
<tr>
<th>Year Ended</th>
<th>March</th>
<th>June</th>
<th>September</th>
<th>December</th>
<th>Year Ended</th>
</tr>
</thead>
<tbody>
<tr>
<td>1948</td>
<td>2.2</td>
<td>2.4</td>
<td>2.6</td>
<td>2.3</td>
<td>9.8</td>
</tr>
<tr>
<td>1949</td>
<td>1.7</td>
<td>2.9</td>
<td>1.8</td>
<td>2.7</td>
<td>9.3</td>
</tr>
<tr>
<td>1950</td>
<td>1.7</td>
<td>2.9</td>
<td>2.5</td>
<td>4.4</td>
<td>12.1</td>
</tr>
<tr>
<td>1951</td>
<td>4.3</td>
<td>7.0</td>
<td></td>
<td></td>
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</tr>
</tbody>
</table>

The arbitration court had raised the basic wage at the end of 1950 but Fadden pointed out that this was 'only one element (and not perhaps the predominant one) in the flood of events exerting increases in the basic wage'. The treasurer pointed out that the simple adjustment of the basic wage in the quarterly cost of living had added about 31/-
to the basic wage in the four quarters since 1950. The reason for the rampant inflation of 1951, Fadden concluded, was that 'too much was being attempted in relation to what can be accomplished with the resources in hand'. Total investment in 1950/1 at £720 million was thirty per cent higher than in 1949/50 and sixty-six per cent higher than in 1948/9. Public investment at £310 million was forty per cent higher than in the previous year and private investment at £410 million was twenty-five per cent higher than in the previous year.

Because of the grossly excessive levels of monetary demand, higher prices can be demanded and will be paid, the higher cost incurred can in turn be passed on in further increases and so the whole structure of domestic prices and costs is slowly pushed upwards.

Fadden concluded that the government had to reduce public and private investment and government expenditure 'by all available measures, foremost of which would be budgeting for a substantial surplus'.

The need to restrain inflation, as well as to increase defence spending, prompted the government to reintroduce some of the wartime controls against which, in opposition, it had campaigned in the nineteen forties. The controls were introduced under the defence preparations act. Menzies explained that Australia needed first of all to increase the trained strength of the armed forces so that effective forces would be available for instant mobilization on the outbreak of war. Secondly, the country needed training facilities in advance, accommodation, and supplies of equipment. Thirdly, it needed to strengthen the whole economy to meet wartime and war preparation demands: if Australia was to obtain more armed strength, it would need more manpower, more materials, more plant, and more resources. He argued that there needed to be central planning to reconcile the needs of the civil economy with defence preparations:

if we try to do all the things that we are trying to do today, and have no effective organisation for putting first things first, we shall not have

defence preparations, development, or stability, but we shall have delays, rising costs, rising prices, inadequate real production, and a disintegrating economy.\textsuperscript{46}

The defence preparations act was designed to give the government power to divert resources for defence preparations, to adjust Australia’s economy in order to meet the threat of war, and to avoid economic dislocation and instability. The powers under the act would be put into operation by the national security resources board. Regulations would be made under four broad headings: the expansion of the capacity of the Australian economy to produce or manufacture goods for defence purposes; the diversion and control of resources for the purposes of defence preparations; the adjustment of the Australian economy to meet the needs of war and to avoid economic instability; and the maintenance and sustenance of the people of Australia and their allies as they prepared for war.\textsuperscript{47}

Evatt, the leader of the opposition, declared that Labor would oppose a bill which gave a blank cheque to the executive to make laws without the previous approval of parliament. Accepting the bill, he said, would be to accept the proposition that Australia was in a permanent or indefinite state of war: it was wrong to assume the inevitability or even the probability of such a catastrophe. Evatt argued that when the Menzies government took power it began to tinker with the orderly programme of postwar reconstruction that had been evolved by the Chifley government. It had failed to stop inflation and now, by creating war fears in the community it had the potential to cause an economic disaster. He criticized the government for giving itself extraordinary powers without seeming to have a plan or programme to implement.\textsuperscript{48}

In the event, the act was found by the high court to be constitutionally valid because the preamble of the act amounted to a statement of purposes within which regulations were to operate, rather than an assertion of facts of which the court was to take judicial notice. In other words the high court was to determine, in the light of the facts of the

\textsuperscript{46} Ibid., p.1114.
\textsuperscript{47} Ibid., pp.1118-9.
\textsuperscript{48} CPD, Vol. 213, 11 January 1951, pp.1402-10.
international situation, whether the act and regulations under the act were valid. In contrast, the *communist party dissolution act* attempted to bypass the court as the arbiter of constitutional interpretation.

Immediately after the election, Menzies introduced legislation to provide for a referendum which would authorize the government to deal with communists. The terms of the referendum gave the Commonwealth a general power to make laws with regard to communism, a power to make a law in the terms of the communist party dissolution act, and a power to amend that law. Menzies was not sure that all the provisions of the communist party dissolution act could have been enacted under the simple head of power to make laws about communism. So to prevent a possible setback in the high court and the inconvenience of further litigation he decided to ask for an additional power to enact the anti-communist bill, and a further power to amend it. This proved to be a disastrous mistake.

Evatt ran a "no" campaign on the basis that the referendum gave the government power to characterise and condemn any persons as communists, then declare them, and thus deprive them of important civil rights either as a group or individually. Menzies tried to argue that the high court's interpretation of the legislation would prevent non-communists or non-communist organisations being brought within its net. He claimed that the referendum did not give the government power to amend the legislation so as to change the definition of 'communist' to include fresh classes of radicals. Evatt rejoined that even if this were so, and the government would not be able to alter the definition of 'communist' in the act, it could easily amend the legislation in other ways. For example it would undoubtedly be empowered to remove the exemption in section five of the act which prevented trade unions from being included among the organisations which could be declared unlawful. Menzies probably never intended to go so far as to dissolve communist led unions, but Evatt was able to prove the potential of the terms of the referendum to embrace other classes of dissenters than
communists. On 21 September, the Australian people voted by a small overall majority to reject the referendum.

In August a sub-committee of the national security resources board consisting of John Storey, Frederick Shedden, H.C. Newman (representing Roland Wilson), I.M. McLennan, and E.R. Walker, recommended a massive increase in defence expenditure. Beginning in July 1950, the government had adopted a three year defence programme consisting of the remaining two years of Chifley's programme plus one year. The proposals considered by the sub-committee were additional to the three years' programme and consisted mainly of plans prepared by the services and associated departments to meet the materials and equipment requirements of the forces to be raised on mobilization and to provide capital equipment and new industrial capacity for that purpose.

The services prepared a programme of material requirements for the forces required on mobilization, based on the strengths approved by the government. The services estimated that this programme would cost approximately £397 million. The army's mobilization establishment was one divisional group (43,000 men), one infantry brigade group (6,500 men), a home defence force (19,000 men) and training establishments (56,000 men). These forces required equipment like tanks and armoured cars, armament stores, telecommunication equipment, and general stores. The Air force would have on mobilization a mobile task force (10,750 men), and a home defence force (6,900 men) totalling in all sixteen squadrons, and training and maintenance establishments (17,075 men). These forces required such items as aircraft and aircraft spares, ammunition and vehicles. To supplement existing ships and supplies, the navy's mobilization requirements included expenditure of £32 million on ship construction, and £40 million on equipment and supplies. £84 million of the total £397 million armed forces and equipment programme could be provided out of the three year defence programme. And the government had already approved the

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49 Argus, 3 September 1951.
expenditure of £70 million on specific defence projects but that left an outstanding cost of £241 million to be approved. 50 Cabinet approved the expenditure of the extra £241 million between 1951 and 1953 on 20 August. 51

In the cabinet’s pre budget sessions, Fadden described the government’s task as to finance a deficit gap of £96 million as well as to provide for a large budget surplus. In searching for new sources of revenue, the treasurer considered that ‘considerable emphasis should be placed on indirect taxation because it does not strike at incentive in the way that direct taxation does’. 52 Having regard to this principle, cabinet decided that only £25 million would be raised in direct extra personal taxation. Two alternative forms of raising this extra income tax were canvassed. The first was a progressive tax where higher incomes would be taxed at a higher rate than lower incomes. The second was a flat rate levy of ten per cent on all incomes. Cabinet opted for the second alternative, deciding to call the tax a special defence levy – to finance the government’s defence preparations programme. The rest of the additional taxation was to be obtained through changing the method of averaging the income of primary producers, through company taxation, and through higher indirect taxation. 53 The new taxation proposals yielded an extra £160 million, and for the first time in the history of the Commonwealth, produced a substantial budget surplus of £114 million.

Menzies, defending the budget, asked two questions: should taxation have been increased, and if it should have, were the increases fairly distributed. Menzies answered the first question by pointing out that had taxation not been increased, there would have been a large deficit, the financing of which would have been inflationary. It was, he said, impossible to cut government expenditure any further. The high

50 ‘Report of the sub-committee of the national security resources board on the armed forces and equipment programme’, 10 August 1951.
51 Cabinet decision 123 on submission 28, 20 August 1951, Fifth Menzies ministry cabinet agenda, CRS A4905/XM Volume 4 AA.
52 ‘Summary of the financial problem’, 21 August 1951, CRS A571 50/1702 AA.
53 Cabinet agendum 101 ‘Income tax and social services contribution’, 17 August 1951, Fifth Menzies ministry cabinet agenda, CRS A4905/XM1 Volume 1, AA.
defence vote of £200 million was essential, and Commonwealth works and general expenditure could not have been pared down further. He went on to argue that since the extra taxation levied was largely in the form of indirect taxation, the burden had been equitably distributed.\(^{54}\) Evatt criticized the government first for inactivity in 1950 and then for over-reacting in 1951. He thought that the increased taxation was too severe and that there was the potential for a depression in 1952 or 1953. Another Labor member, Kim Beazley, argued that the budget surplus would have been more anti-inflationary and more equitably levied if it had been obtained by direct taxation. He further criticized the government for using the budget surplus to underwrite that part of the state loan programme left unfunded by the sale of bonds to the public. The effect of this was to diminish the anti-inflationary impact of the surplus. And the Labor member for East Sydney, Eddie Ward, attacked the government’s defence vote for 1951/2, which at £200 million was nearly four times more than what it had been in the last year of the Chifley government.

As it turned out, the so called 1951 ‘horror budget’ was not a significant cause of the lessening of inflation. Fadden pointed out a year later that ‘the state works programme, which we had underwritten to ensure the continued progress of essential projects, actually cost us, out of revenue, substantially the equivalent of our increased tax revenue.’ External factors halted the rapid rise of the inflation rate. In the middle of 1951 the United States ceased its exorbitant purchases of Australian wool. The inflation rate steadily fell. And Australia reached a situation where she was sucking in a huge volume of imports without any longer being able to generate the foreign exchange to pay for them.

By late 1951 the Menzies government was conscious of impending economic crisis. Trevor Swan, of the economic division of the prime minister’s department, pointed out to Menzies in December 1951 that if Australia continued to import at the present rate, there would be an import surplus of £300 to £600 million in 1952/3: ‘for

\(^{54}\) \textit{CPD}, Vol. 214, 3 October 1951, pp.275-85.
the first time since the war, goods are coming in on a large scale without export
incomes or external capital finance to support their purchase'. Swan urged the
government to intensify its anti-inflationary programme, despite the danger of
cauising unemployment, if the country was not to be faced with 'inflationary pressure
of new violence, and an acute balance of payments crisis which between them could
destroy both the economy and the government.' Swan argued that the total of goods
and services being invested and consumed in Australia 'is greater than we can provide
for out of our own production and by drawing to the maximum conceivable extent on
our overseas resources.' Swan's solution was to reduce aggregate consumption and
investment by ten per cent by reducing demand 'to the point where we are using a
smaller volume of resources than we are succeeding in using.' 55

In March the government decided to tackle the balance of payments problem, not
by restricting demand further, but by reducing the amount of imports coming into
Australia in 1952/3 by half. On 9 March it announced a decision to slash imports on
most types of goods brought into Australia, including British goods, some by eighty
per cent, some by forty per cent. 56 As Butlin, Barnard, and Pincus, have pointed out,
import licensing and quota restrictions became the key instrument for Commonwealth
government policy directly determining the conditions of domestic competition with
foreign imports but also regulating the flow of foreign inputs into local
manufacturing. 57 Evatt immediately attacked the import restrictions as a repudiation
of the recent agreement at the Commonwealth finance ministers' meeting in London to
bolster and protect sterling. He pointed out that the downward trend in the Australian
balance of payments had been evident for some time, but instead of taking earlier
remedial action, the government had done nothing. Now it was solving the problem by

55 'Notes on economic policy', by Trevor Swan, 3 December 1951, Menzies Papers, MS 4936 series 21,
Box 438 folder 4 NLA.
56 SMH, 8 March 1951.
imposing stringent restrictions on British goods. 58 Likewise the Sydney Morning Herald was staggered by the ‘abrupt reversal of policy’ which indicated ‘confusion in the minds of ministers’.59

This confusion in cabinet was evident in a discussion on economic policy on 17 March. Some members of cabinet expressed doubts as to whether the economy was continuing to experience inflation at all — and whether it was not in a deflationary stage. Many expressed concern that official statistics were understating the degree of unemployment, particularly of women. One view was that ‘it may perhaps be necessary to pump into the economy some credit in appropriate fields where otherwise there might be an unwanted falling off in demand – maybe in the housing sector’. Another was that Labor would gain control of the senate in 1953 and, by blocking supply, force the government to an election earlier than expected in an unfavourable economic climate. However the consensus of the meeting was that the government should continue with a broadly anti-inflationary programme.60

On 7 May 1952 the Labor opposition was able to make good ground against the government in a debate over the financial statement presented to parliament to justify the government’s policy of imposing import restrictions on British goods. Beazley, for example, criticized the Menzies government’s running down of the sterling balances built up so assiduously by Chifley. He argued that if Chifley’s policy of restricting consumption by rationing had been preserved, and if luxury imports had been restricted earlier, the government would not have been put in the position in 1952 of having drastically to slash imports. 61 Ward pointed to rising unemployment as well as to the strain on the country’s resources and asked why this was occurring. He answered

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58 SMH, 9 March 1952.
59 Ibid., 11 March 1952.
60 Cabinet minute, 17 March 1952, fifth Menzies ministry cabinet agenda, CRS A4907/XM Volume 1 AA.
that it was because the government was attempting to execute a war preparations programme that would cost £888 million in a period of five years. 62

The recession of 1952 which followed the period of severe inflation in 1950/1 was in fact worse than the credit squeeze of 1960 which almost brought Labor to office. In his evidence in the 1952/3 wage case, H.P. Brown estimated that males unemployed at the trough of the recession comprised four per cent of the work force and that 'generally speaking, the decline in female unemployment has been relatively greater than male unemployment'. At the end of July 1952, Evatt declared that the 'plain fact is that full employment no longer exists'. Shortly afterwards the ACTU called for a total ban on employable immigrants. Despite immigration minister Holt's objection that his critics could not claim 'at one and the same time that migration adds to inflationary pressure and deprives Australians of jobs', he announced in July the reduction of the intake of immigrants in 1953 from 150,000 to 80,000. 63 By the end of 1952, when in normal circumstances Menzies' first term would have ended, the stocks of the government were low. Inflation had come down but it was still fairly high, and unemployment was growing. The Age noted in July the government's unpopularity and blamed it on the coalition's 'egregious assurance that... it would restore the value of the pound' at the same time as it would deliver 'a substantial reduction in taxation'. 64

Despite the government's resolve to stick with an anti-inflationary programme, it took many decisions which encouraged expansion. Import restrictions encouraged local manufacturing. In May the Commonwealth made its advance policy easier. In July hire purchase restrictions for farm equipment were relaxed. And in August 1952 the treasurer in his budget speech said that, despite the persistence of cost inflation, 'there was not the same compelling reason that we had a year ago for seeking a large

63 A.M.C. Waterman, Economic Fluctuations in Australia, 1948 to 1964, Canberra, 1972, p.91.
64 Age, 1 July 1952.
budget surplus.' 65 In consequence there were tax concessions of £49.6 million, including the abolition of the special defence levy, and the budget was nominally balanced. Then in October the Commonwealth bank relaxed virtually all selective controls over bank advance policy.

Evatt in his reply to Fadden's budget speech recommended a much more expansionary economic strategy. He suggested that treasury bills should finance a 'substantially higher public works programme and that a lower rate of interest should be fixed in order to encourage higher private investment.' Menzies replied with his usual formidable debating powers. He attacked Labor's economic policy as inflationary. He estimated that if Evatt were in office, Labor's social services promises would cost an extra £60 million. The state works programme was costing £190 million, and being funded to the tune of £55 million by the loan market, leaving £130 million to be financed by the Commonwealth. Menzies argued that under Evatt, the state works programme would have been the full £270 million recommended by the loan council – most of which would have to be financed by treasury bills, given Labor's policy of low interest rates. The total effect of Labor's policy, Menzies argued, would have been a deficit gap of between £350 and £400 million to be financed by treasury bills.66 Labor's economic thinking was still influenced by fear of depression. These fears proved unwarranted. Unemployment steadily fell in 1953 and the inflationary position eased so that retail prices rose by only two per cent in 1953. By this time the government could congratulate itself on achieving the stability it had set out to achieve in 1951.

Conclusion

The Menzies government represented its victory in December 1949 as a triumph for free enterprise and a rejection of socialism. This was a myth. The Chifley government,

like its successor, was broadly in favour of free enterprise. Where the Chifley government differed was in the emphasis it placed on economic controls to preserve stability, protect the sterling area, and prepare for depression. The Menzies government came to office on the basis that it would put value back into the pound at the same time as it stepped up Australia’s defence preparations. Overturning Chifley’s fiscally conservative policy of economic security, Menzies instituted a policy of national development involving more expenditure on defence, and public and private investment. Concurrently he implemented a programme of economic controls under the defence power so that the programme of national development could go ahead without destroying the economy. This policy involved running a huge import surplus. Menzies’ policy succeeded because of Australia’s improvement in earnings of foreign exchange during the Korean war wool boom. When the boom ended in 1951, Australia’s economy suffered an acute balance of payments crisis. Menzies was forced to reintroduce import restrictions, and unlike Chifley, he had no hesitation in slashing imports of British goods. An integral part of the government’s overall programme was the anti-communist bill. Production would be increased and inflation reduced, Menzies declared, if only communists could be excluded from the trade unions. Labor suffered for its resistance to the bill. It also opposed Menzies’ basic programme of expanded defence and development. But by 1952 rearmament was a fact. Labor’s calls for more welfare would have to compete with this high level of defence spending. Menzies could easily show that Labor’s economic policies would lead to ruin.
CHAPTER SEVEN - THE RETREAT FROM THE STERLING AREA

The spectre of the dollar shortage and the possibility of depression in the United States hung like a pall over the Chifley government in the period of postwar reconstruction. In spite of Marshall aid, the sterling-dollar gap widened. The grandiose plans for international collaboration based upon article VII of the mutual aid agreement had failed to provide Australia with security against depression and with defences against the dollar famine. Chifley had failed to get the international guarantee of full employment which had been the main reason for his acceptance of the principle of multilateralism. In his last year in government he had serious doubts that the Americans would take steps to end the dollar shortage and so provide the sterling area with the *sine qua non* for the successful establishment of multilateralism. Menzies inherited the dollar problem at its most serious stage. Having come to power partly on the basis of opposition to Chifley's pro-sterling area economic policy, his handling of the dollar situation would be a critical test of the success and survival of his government. Fortunately for Menzies, two things worked towards alleviating the dollar shortage. The first was a successful American initiative to mitigate the sterling-dollar problem after September 1949. The second was the huge military spending of the United States occasioned by the outbreak of the Korean war. These two processes paved the way for the beginning of Menzies' political hegemony. The Menzies government struck out on a different path from Chifley by retreating from the sterling area. The new government disliked the controls and restrictions associated with Labor’s policy of protecting the sterling area: the limited access to American goods, dollar import restrictions, rationing, the reluctance to borrow from the United States, and limitations on the inflow of American capital. If there was a turning point in the history of Australian capitalism it came with Menzies' accession to power and his abandonment of Chifley’s policy of unwavering support for an economically moribund United Kingdom.

*The New American Foreign Economic Policy and Rearmament*
In September 1949 the British, the Americans, and the Canadians met in Washington to discuss the sterling–dollar problem. The British view was finally getting through to the Americans. Before the talks took place, the state department persuaded the Truman administration to adopt a form of international state planning to solve the dollar problem. It argued that the Americans had to suspend for the moment their policy of dismantling the sterling area by enforcing non–discrimination and convertibility. This was a drastic departure from traditional multilateralist dogma represented in the views of the treasury secretary, John Snyder. Snyder had rebuked Cripps in July for proposing ‘international state planning in a positive manner as a method of coping with [the] recurrent dollar crises of [the] UK.’ 1 The British chancellor of the exchequer had proposed a compromise between the two–world policy favoured by some sections of the British Labour and Conservative parties, and Snyder’s favoured option of the United Kingdom’s immediate entry into a multilateral system based upon convertibility and non–discrimination. The British would devalue sterling in order to make sterling goods more competitive in American markets; and in return Cripps wanted the Americans to prop up the sterling area by allowing it to discriminate against the dollar temporarily, by reducing American tariffs, and by supporting the prices and stepping up the purchases of sterling area raw materials such as Malayan rubber and Australian wool.

The state department managed to wrest control of the American delegation to the economic talks from Snyder.2 It recommended that the United States government should reassure the British of its willingness to make a contribution to solving the dollar problem. The United States government should tell Britain that it was determined to go through with the Marshall Plan and to allow the United Kingdom to build up her dollar reserves and to spend them freely. It should announce a review of

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1 The secretary of the treasury (Snyder) to the secretary of state, 9 July 1949, Foreign Relations of the United States (FRUS), Volume IV, 1949, p.800.

customs practices from the point of view of facilitating imports; allow Marshall dollars to be spent on 'offshore' items like Australian wool; and take measures to step up American purchases of natural rubber, which was the sterling area's largest dollar earner. This was roughly the position which the Americans put to the British delegation in Washington after being informed of the British government's intention to devalue sterling.

The United States government gradually came to accept the view that simply providing foreign countries with aid to buy American goods was only a partial solution to the dollar problem. The United States needed actually to buy more goods from the rest of the world and particularly from the sterling area. America's new foreign economic policy began to crystalize when the secretary of state, Dean Acheson, advised the president to develop a concrete policy for adjusting the balance of payments of the United States. Acheson pointed out that the United States annually exported about $16 billion of goods and services but imported only $10 billions. The difference, about one third of America's exports, was being paid for by extraordinary foreign assistance. He argued that at the end of the Marshall Programme the problem of payment for American goods and services would remain. The problem was this: how could Europe and other areas of the world obtain the dollars to pay for the high level of United States exports which was essential to their basic needs and to the well being of the United States economy? The state department feared that when American foreign assistance tapered off, a depression would be triggered. United States exports would fall; domestic and foreign production would be reduced; world trade would diminish and become subject to increasing restrictions designed to safeguard foreign monetary reserves; standards of living throughout the world would drop; and employment throughout the world would suffer. Acheson's conclusion was that if America's

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3 Position paper for the discussions with the British and Canadians on pound-dollar problems, prepared by the policy planning staff, 3 September 1949, FRUS, Volume 1, 1950, pp.834–7.

4 Memorandum by the secretary of state to the president, 16 February 1950, FRUS, Volume 1, 1950, pp. 834–7.
exports to other countries were to be maintained, the United States would have greatly to increase her imports of goods and services. This would require a change in our traditional attitude towards imports, and a willingness to place the economic interests of the nation as a whole, plus its international and security interests, above the special interests of particular groups which may have to face increased competition from abroad.\(^5\)

Truman responded to Acheson’s representations by appointing Gordon Gray as special assistant to the president in order to study the balance of payments problem and propose solutions to it. Truman wrote to Gray:

Our basic purpose has been, and must continue to be, to help build a structure of international economic relationships which will permit each country, through the free flow of goods and capital, to achieve sound economic growth without the necessity for special financial aid. We cannot continue to sell our goods abroad, or receive a return on our public and private investments abroad, unless foreign countries can obtain the necessary dollars to make their payments.

From the middle of April, the Gray commission set out to determine how the United States would reconstruct the international economic system after the Marshall Plan ended.\(^6\)

One result of the new foreign economic policy of the United States was increased purchases of natural rubber. The Japanese invasion of South East Asia in the second world war had cut off the supplies of Malayan rubber to the United States. Consequently the United States had developed the manufacture of its own synthetic rubber. In 1948 congress had moved to protect American synthetic rubber against sterling area natural rubber by mandating a minimum level of synthetic rubber consumption. This protectionist measure was one of the contributors to the sterling area’s disastrous dollar crisis in 1949. It meant that no matter how high the price of American synthetic rubber rose, natural rubber could only be imported after the synthetic quota had been consumed. The British repeatedly complained about this case of American protectionism until at the end of 1949 the Americans came to appreciate

\(^5\) Attachment to the memorandum to the president of February 16 1950, FRUS, Volume 1,1950, pp.838–41.

\(^6\) Rotter, op. cit., p.147.
the relationship between the United Kingdom's economic troubles and the South East Asian connection. As Andrew Rotter has argued, American policy congealed around a new idea: that certain elements of colonialism and protectionism had to be preserved if the essential objects of British economic recovery and the containment of communism were to be attained. Specifically, the Americans would support British colonialism in Malaya and protect the price and sales of natural rubber. In January 1950 the American national security resources board submitted a new rubber bill to congress giving the president the authority to set a mandatory usage requirement for synthetic rubber, without recommending any amount or percentage. This was a victory for the state department and for Truman.

The end of the American recession in late 1949, the devaluation of sterling, and a reduction in the synthetic quota under the 1948 rubber act, led to an enormous increase in the amount of natural rubber purchased by the United States. Monthly consumption of natural rubber soared from 44,000 tons in September 1949 to 60,000 tons in January 1950. Between September 1949 and June 1950, Malaya earned a trade surplus with the United States of $185.7 million, $142 million more than the next highest contributor to the sterling area dollar pool. Indeed the $220 million surplus which the sterling area earned in the first quarter of 1950 had very little to do with increased exports from the United Kingdom: it was mainly due to increased purchases of Malayan rubber and tin, and to a lesser extent Australian wool.

The change in the foreign and defence policies of the United States after 1950 also contributed to the closing of the dollar gap. In January 1950, president Truman responded to the position that confronted the United States over the communist victory in China in 1949, the Sino–Soviet pact, the continued economic crisis in western

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7 Ibid., pp.58–64.
8 Ibid., pp.149–51.
9 Ibid., pp.151–2.
10 'Sterling area gold and dollar surplus', memorandum by J.F. Nimmo, 1 July 1950, CRS A571/1 50/2227 Part 7 AA.
Europe, and the recent explosion by the Soviet Union of an atomic device. Truman authorized the state and defense departments to 'initiate a re-examination of our objectives in peace and war and of the effect of these objectives on our strategic plans, in the light of the probable fission bomb capability and possible thermo-nuclear bomb capability of the Soviet Union.' Truman received a report on 7 April which subsequently became known as NSC–68. 11

NSC–68 diagnosed a fundamental conflict in the realm of ideas and values between the United States and the Soviet Union. The policy paper considered that the Kremlin design called for 'the complete subversion or forcible destruction of the machinery of government and structure of society in the countries of the non–Soviet world and their replacement by an apparatus and structure subservient to and controlled from the Kremlin.' Despite the fact that the economic strength of the Soviet Union was one–fourth that of the United States, NSC–68 noted that Russia was reducing this discrepancy in economic strength by devoting proportionately more of its economic resources to capital investment than the United States. The president’s military advisers thought that the Soviet Union’s preparations were sufficiently advanced to carry out a number of campaigns in 1950. The Soviets could overrun western Europe, drive towards the oil bearing areas in the Near and Middle East, and consolidate communist gains in the Far East. They could launch air attacks on the United Kingdom and sever her line of communication with the United States. They could also attack selected targets in the United States with nuclear weapons. Indeed the Americans estimated that by 1950, the Soviet Union would have a fission bomb stockpile of two hundred. NSC–68 drew two conclusions about the economic strength and defence preparedness of the potential enemies of the United States. First, the Soviet Union was widening the gap between its preparedness for war and the unpreparedness

of the 'free' world. It was devoting a far greater proportion of its resources to military 
spending than the 'free' world was and, in significant components of military power, a 
greater absolute quantity of military resources. Secondly, the communist success in 
China, together with the political and economic situation in the rest of South East Asia, 
provided a springboard for communist incursion into that area. 12

NSC–68 considered four options which the United States could take to counter 
the perceived Soviet threat. The first was to continue the existing defence programme, 
with military expenditure running at about six or seven per cent of American gross 
domestic product. The second was for the United States to retreat into isolation. The 
third was actually to provoke war with the Soviet Union. And the fourth was a more 
rapid build up of the political, economic, and military strength of the 'free' world with 
the purpose of reaching a state of complete military preparedness for any contingency. 
NSC–68 rejected the policy of keeping defence expenditure at existing levels because 
this would force the 'free' world on the defensive and into a dangerous policy of bluff 
with the Soviet Union about its military strength and its ability to mobilize. NSC–68 
rejected the options of isolation or an American initiated war, and recommended a 
massive increase in American defence expenditure. A more vigorous military 
programme would supplement the existing administration programme to adjust the 
balance of payments of the United States. This would help to close the dollar gap, to 
achieve international equilibrium, and to bring about a rapid improvement in the 
economic and social structure of the other countries in the free world.13

In the middle of November 1950 the special assistant to the president, Gordon 
Gray, released his report on American foreign economic policy. Gray's report 
endorsed multilateralist orthodoxy that economic progress for the United States, for 
the other industrialized nations, and for the underdeveloped world, required the 
elimination of the trade barriers that obstructed world trade. He noted, however, that

13 Ibid.
certain aspects of American import and domestic policy were perpetuating a shortage of dollars in the rest of the world and thus impeding the 'free' world's progress towards multilateralism. American rearmament would mitigate the dollar shortage:

While it is still too early to measure the magnitude of the effects of rearmament, certain basic trends are clear. Our own rearmament program will require us to import strategic raw materials in greater quantities than before. Other nations will also have increased demand for such commodities. The diversion of American productive effort to military defence will reduce the supply of goods for civilian consumption in this country. It will also reduce the quantity of civilian goods which we can ship abroad. This means that our demand for civilian imports from other countries will increase.

In short, we will be paying more abroad for raw materials, and we will be buying more imported manufactured goods. As a result more dollars will be available through trade channels to the rest of the world. The rapid elimination of our export surplus in recent months is a reflection of some of these trends.\(^{14}\)

Gray made a number of recommendations and observations to Truman. The United States should continue to supply aid, both military and civil, to western Europe for the next three or four years. In view of the special importance of the sterling area to United States security, the Americans should ensure that the United Kingdom's own rearmament programme did not destroy its balance of payments. The sterling area was an indispensable source of raw materials and the position of the United Kingdom as banker and trading centre of the world's largest currency area made Britain's trading and currency policies of great importance to the realization of America's foreign policy objectives. Moreover the development of a healthy trading position for the European countries, the economic structures of which were adjusted to a historical deficit in trade with the United States, required an 'increasing ability on their part to earn some dollars in multilateral trade with the sterling area'. For the first time since the end of the war, the sterling area outside the United Kingdom had become a net earner of dollars. The rise in rubber and tin prices alone from January to June 1950 would increase Malaya's earning of dollars by $200 million annually. And a heavy

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demand for wool might well shift Australia from the position of a dollar deficit country to a net dollar earner. It was hoped that the sterling area’s dollar reserves would increase sufficiently to allow the convertibility of sterling as a first step in the eventual reconstruction of multilateral trade.  

NSC–68 and the beginning of hostilities in Korea in June 1950 had a spectacular effect on the Australian economy. In order to clothe the vastly expanded American armed services, the United States stepped up her purchases of Australian wool and bid up the price at the auctions. The average price of wool per lb rose from only 46.8d in 1948 to 140d in 1950/1 and 190.5d by March 1951. The combined effect of America’s changed foreign economic policy and her rearmament programme had an equally spectacular effect on the health of the sterling area as a whole. The United Kingdom government announced that the sterling area’s gold and dollar reserves were $2,756 million, almost double what they were at the nadir of the United Kingdom’s economic fortunes in September 1949.

The heavy American demand for Australian wool caused the United States government to worry that it would not be able to get enough wool at auction to satisfy the military requirements of its armed services. The problem as the Americans saw it, was first to get their military requirements, secondly to get them at reasonable prices, and thirdly to prevent wool going to their potential enemy Russia. They asked the Australian government to modify the wool auction system to suit America’s interests. The Australian government had three possible ways to reply to this request. They could do nothing and simply let the Americans buy their wool at auction. But the result of this might be that the price of wool rose so high as to price the United Kingdom out of the wool market. Russia would moreover continue to buy wool freely from

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15 Ibid.
17 ‘Sterling area gold and dollar reserves’, memorandum by J.F. Nimmo, CRS A571/2 50/2227 Part 7, AA.
Australia in violation of the United States' request that its enemy be hindered from preparing for war. The second alternative was that the Australian government could compulsorily acquire the wool clip and distribute it itself. The third alternative was to abstract the American military requirements from the clip and allow the balance to go to public auction.  

The American wool proposals were the subject of a conference in London in September and October 1950. The meeting comprised the United Kingdom, the United States, and the dominion woolgrowers, Australia, New Zealand, and South Africa. John McEwen, the minister for commerce and agriculture, represented the Australian government at the wool conference. Menzies advised McEwen to steer the Americans away from a pre-emptive scheme. He wished McEwen simply to assure the Americans that the dominion woolgrowers would guarantee the military supplies of the United States. Raw wool would continue to be bought at auction in the normal way and only in extreme circumstances would Australia institute a system of pre-emption. He was not happy about putting an embargo on sales of wool to the Soviet Union, and he urged McEwen to extract from the Americans a guarantee to supply Australia with urgently needed materials for defence and development, as a quid pro quo for Australia's assistance of the United States with wool.  

After much haggling with the Americans, McEwen succeeded in whittling down the American demands to 'very much smaller and more manageable proportions'. McEwen himself thought that the American request for an international allocation scheme to distribute wool could not even be considered unless the Americans definitely related their request to military purposes; and unless other raw materials in short supply were the subject of more or less similar proposals. McEwen was not going to allow the price of wool to be controlled if the prices of commodities which Australians

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18 Cablegram 4590, McEwen to Menzies, 23 September 1950, CRS AA1969/224/1 161, AA.
19 Cablegram 4811, Menzies to McEwen, 2 October 1950, and 4844, 4 October 1950, CRS A1969/224/1 16, AA.
consumed were not similarly controlled. At the conference McEwen rejected any proposal for the abandonment of auctions and the compulsory acquisition of the Australian wool clip, and succeeded in quashing an item declaring an embargo on wool sales to Russia. Menzies and McEwen did not want Australia to incur the odium for carrying out America’s policy of denying strategic materials to Russia.

**Fissures in the Economic Relationship Between Australia and the United Kingdom**

In 1950 the United Kingdom government remained cautious about whether the Americans would develop a concrete policy to adjust their balance of payments. Because the British were uncertain whether the Americans would deliberately increase their purchases from the sterling area in order to bridge the dollar gap, they continued to implement policies which made the sterling area more self reliant and less dependent on dollar sources of supply. To do this they would substitute commodities which cost fewer dollars for commodities which cost more dollars – a process essential in the elimination United Kingdom’s dependence on foreign aid. The British had already reduced their dependence on the United States for food, and in late 1949 turned their attention to reducing their dependence on dollar oil – the largest item in the dollar payments of the sterling area. At this time the British controlled oil companies were building up temporary surpluses of oil. On 1 January 1950, the British government announced a policy of substituting the oil surpluses of the British controlled oil companies for oil imported into the sterling area by American oil companies. The United Kingdom government wanted all sterling area countries to participate in the substitution scheme to avoid the possibility of the American oil companies switching

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20 Cabinet agenda, ‘London discussions of the American proposals for the allocation of wool supplies’, 11 September 1950, fourth Menzies ministry cabinet agenda, CRS AA4639/XM Volume 1, AA.

21 Cablegram 5092 McEwen to Menzies, 16 October 1950, CRS AA1969/224/1 161, AA.

22 ‘Sterling oil – dollar oil problem— memorandum of the United Kingdom government’, February 1950, CP 434/1/1 3402; ‘Copy of message received from Mr Attlee’, 21 January 1950, fourth Menzies ministry cabinet agenda, CRS AA4639/XM Volume 2, AA.
onto one Commonwealth country dollar supplies excluded by substitution from another. 23

The Menzies government was determined to embark on a new foreign economic policy. In Spender’s first statement on international affairs on 9 March 1950, he said:

it is highly desirable for Australia that the political affinity of Commonwealth countries and western Europe on the one hand, and the United States and Canada on the other, should not be disturbed by conflicts in commercial and other policies. 24

He promised that the Australian government would in future conduct her foreign economic policy so as to overcome the difficulties in her commercial and cultural relations with the United States. Menzies had already promised to end petrol rationing in Australia. And he was not pleased about the United Kingdom policy of oil substitution. To participate in a scheme of discrimination against American oil companies would be unfortunate in view of the new government’s declared policy of friendship towards the United States, expansion of Australia’s dollar export trade, and encouragement of the flow of American capital into Australia. 25 On 17 January Menzies cabled Attlee to justify the Australian government’s cessation of petrol rationing. He argued that Australia was peculiarly dependent on road transport for the movement around the country of the wool clip, agricultural supplies, and essential industrial supplies. The development of Australia and her capacity to improve as a dollar earner was conditional on her having greater access to petroleum products. To compensate for derationing petrol, Menzies reluctantly agreed to participate in the oil substitution scheme, but he added that Australia as a Pacific nation had to cultivate a closer association with the United States of America. 26

23 ‘The substitution plan – position of the UK government vis a vis the US government and US oil companies’, n.d. cabinet sub-committee on overseas commercial relations agenda, CRS A4933/XM1 Vol.26, AA.
25 Cabinet agendum 18, ‘Petroleum products’, fourth Menzies ministry cabinet agenda, CRS A4639/XM Volume 2, AA.
26 Ibid., cablegram Menzies to Attlee, 17 January 1950.
Attlee sent a strong remonstrance to Menzies on 21 January. He stressed that the United Kingdom government had no intention of restricting supplies of petroleum products below an essential minimum necessary for industrial and farming purposes. He reiterated that the dollar drain could only be stopped by retaining restrictions on consumption throughout the sterling area to allow British oil companies to build up surpluses which could be used to replace oil imports from dollar sources. Australia's derationing of petrol would increase the dollar drain, either directly if the extra petrol imported into Australia came from dollar sources, or indirectly if oil supplies intended for substitution had to be diverted to Australia to satisfy consumer demand. Attlee pointed out that Australia was breaching the gentleman's agreement of the Commonwealth finance ministers' conference. The derationing of petrol in Australia would increase consumption by a quarter of a million tons, while the amount of oil in the sterling area available for substitution was a mere half a million tons. Thus Australia's decision would stultify the British government's oil substitution scheme and embarrass its attempts to justify the scheme to the Americans on the ground that it was saving the sterling area dollars. 27 Hugh Gaitskell, the British minister for fuel and power, privately described the Australian decision as the height of irresponsibility. He deplored the 'specious' arguments employed by the Menzies government in its defence, but noted that 'any other course would split the [Australian] government wide open'. 28

In January 1950, while attending the Commonwealth foreign ministers' conference in Colombo, Spender provided the British with an estimate of Australia's position in relation to the commitment Chifley had made to the British after the Commonwealth finance ministers' conference in July 1949. Chifley had agreed to restrict dollar import licensing as far as possible without disrupting Australian industry, to continue petrol rationing, and to borrow dollars from the International Monetary Fund. By taking these three measures he thought he could reduce Australia's

27 Attlee to Menzies, 21 January 1950, fourth Menzies ministry cabinet agenda, CRS A4639/XM Volume 2, AA.
dollar expenditure by twenty-five per cent of the 1948 level. Because of Menzies’
decision to abolish petrol rationing, Spender estimated that Australia would fall short
of the target by $20 million. 29 The British were extremely unhappy with this position
and pointed out that Australia, while professing to want closer economic cooperation
in the Commonwealth, was unilaterally taking a measure which increased her dollar
expenditure, embarrassed other Commonwealth governments, and had the potential to
set off a heavy drain on the dollar reserves of the sterling area. 30 Spender remained
firm. As he recalled later:

Finally I had to make it clear that Australia had to determine her own
national policy, she had done so and that petrol rationing would be lifted,
somehow the dollars would have to be made available. Thus the matter was
‘settled’. 31

The issue of petrol rationing placed a severe strain on Anglo–Australian
relations and could have proved extremely embarrassing for Menzies. Fortunately for
him, the United States government was unhappy about the displacement of American
oil companies from the sterling area. The state department considered that the British
had not made an ‘adequate effort to meet [the] American oil companies’ suggestion of
arrangements by which the dollar drain on oil account could be substantially reduced
without displacing American companies’. 32 By the middle of 1950 the British
companies had increased their production of oil markedly and the American
companies agreed to accept sterling instead of dollars for their supplies of petroleum
products from the British Commonwealth. This remarkable turn of events allowed the

29 ‘Financial and economic decisions at Colombo – January 1950’, report prepared by Spender for the
cabinet committee on overseas commercial relations, 6 February 1950, CRS A461/2 T326/1/4, AA.
30 Record of conversation between the secretary of state for Commonwealth relations, Percy Spender,
and J.J.S. Gamer, 11 January 1950, Public Record Office, joint copying project, DO 121/120 NLA.
32 Important problems which require urgent solution, FRUS, Volume III, 1950, pp.1611–12. The
Americans even contemplated threatening to reduce Marshall aid to the United Kingdom, if the British
continued to spend free dollars on expanding sterling petroleum facilities at the expense of American
facilities.
United Kingdom to end petrol rationing throughout the sterling area in the middle of 1950.33

In opposition to the Chifley government, the coalition parties had made a political issue of what they saw as Labor's unquestioning adherence to the economic policies of the United Kingdom in its role as leader of the sterling area. In government, the Menzies ministry chafed at the restrictions, rationing, and shortages, caused by the sterling-dollar problem. It was not surprising, therefore, that the Menzies government took steps to develop a policy which would make Australia less dependent on a weak sterling area prone to intermittent economic crises. It had a ready ally in the person of the distinguished economist, Douglas Copland. Born in 1894, Copland had been professor of commerce in Melbourne from 1924 to 1944. Appointed by Menzies as prices commissioner in 1939, he served the wartime Labor governments as an economic adviser. He was, however, closer to Menzies than to Chifley. He was ambassador to China from 1946 to 1948 and from 1948 to 1953, he was vice chancellor of the new Australian National University. Copland argued that the key to the dollar problem was to be found in overseas sterling countries obtaining large scale dollar loans from the United States which could be used to finance the capital imports necessary for their development as independent dollar earners.34

Copland pointed out that before the war, the United Kingdom had balanced its trade deficit with the United States through an offsetting surplus with several overseas sterling countries which themselves had a trade surplus with the United States. In other words the United Kingdom earned the dollars necessary to finance imports from the United States with the proceeds of the export of raw materials like rubber, tin, jute, and wool. But after the war, the overseas sterling countries had trade deficits with the United States. Indeed in 1949 the overseas sterling countries were responsible for two

thirds of the United Kingdom's deficit on current account with the United States. Australia's dollar deficit in the four years after the war was $400 million, or one fifth of the last line reserve that the United Kingdom regarded as necessary for maintaining sterling as a viable currency. Copland's solution to this problem was for overseas sterling countries, like India, Australia, and New Zealand, to approach the United States individually for dollar loans so that they could develop a dollar earning capacity. He predicted that the United States would need raw materials and foodstuffs and that the British dominions were in a position to supply them. A further advantage of dollar loans was that they would relieve Commonwealth countries from the necessity of drawing down their sterling balances in order to finance their development. The implication of Copland's ideas was that the overseas sterling countries should take the initiative in dismantling the sterling area. Australia should cease discriminating against dollar trade, become independent of the sterling bloc, and move into the economic orbit of the United States.35

The Menzies government enthusiastically pursued the idea of obtaining dollar loans. A report prepared for the International Bank for Reconstruction and Development (IBRD) explained why it wanted a dollar loan. Australian development plans were not concentrated upon a programme of industrialisation. Australia was already one of the most highly industrialized countries in the world with 35 per cent of wage and salary earners employed in factories and only 13 per cent of the total working population engaged in rural industry. The aim of the government was simply to expand existing productive facilities to accommodate about 200,000 migrants a year with undiminished standards of living. In particular, it wished to expand the production of foodstuffs and raw materials which were Australia's main dollar earning commodities.36

35 Ibid.
36 'Economic development in Australia', 8 August 1950, CRS A816/1 11/301/739, AA.
The Australian economy was dominated by backlogs in the availability of capital facilities. Moreover in the three years before 1950 Australia had absorbed 350,000 immigrants without external assistance. On the contrary, she had accumulated sterling balances and tended to make 'unrequited' exports to the rest of the world. Inadequate supplies in soft currency countries and a severe restriction of supplies from North America held up the flow of imports to meet Australia's shortages. Inflation had consequently been running at a rate of ten per cent per annum since 1947. Inflation had been caused by Chifley's carrying out a great development programme without access to capital goods from America. The types of supplies which the Australians urgently needed from the United States were tractors, earth moving equipment, mining machinery, machine tools, manufacturing materials, and materials for the building industry. If the new government could obtain these essential capital goods through dollar loans, it could increase production in key industries like coal and steel, slow down inflation and speed up the pace of Australian development.

The proportion of primary production to total Australian production was of the order of twenty-five per cent. Yet primary production was about ninety-five per cent of Australia's exports. The Australian government argued that the world demand for these primary products was likely to be strong in the future. So there was a good prospect of Australia earning an export surplus in the future to pay for an import surplus financed by dollar loans.37

The United States government was disposed to look favourably on the Australian application for a dollar loan. Its whole attitude to the sterling area and to the sterling-dollar problem had altered. A state department policy paper of April 1950 noted that an adverse balance of dollar payments was the outstanding problem affecting the relations between the United States and Australia. Rather than seeing American exports to Australia curtailed further by import restrictions, the state department thought that it would be of mutual benefit to both countries if the United States imported more from

37 Ibid.
Australia. It criticized Australia’s long standing policy of empire trade preference and its practice of entering into long term bulk purchase agreements with the United Kingdom, but noted that in recent years Australia had shown a willingness to cooperate with other countries in bringing about freer world trading conditions. It appreciated that the Menzies government was much more in favour of American investment than its predecessor, considered Australia a good risk, and recommended supporting any Australian bid for dollar loans from the IBRD or the Export–Import bank. It also recommended technical assistance to Australia’s Snowy River project under the Point IV programme. 38 The state department was pleased that the new government was not so critical of the United Kingdom’s integration into Europe as its predecessor. And it approved Australia’s policy of resettling displaced Europeans in Australia.39

The United Kingdom government sought privately to discourage the Australian government from taking out a dollar loan. The British were already approaching the United States on behalf of the entire sterling Commonwealth for assistance in the South and South East Asian region. 40 The British pointed out to the Americans that of their £3,967 million sterling debt, £1,185 million were held by India, Australia, Pakistan, Ceylon and New Zealand. Australia’s sterling balances had increased by the middle of 1950 until they were second only to those of India. IMF statistics showed that the total foreign exchange holdings of Australia in February 1950 were the equivalent of $1,075 million or £500 million. 41 The sterling balances of these Asian and Pacific countries represented not only their external reserves but also the funds upon which they relied to finance their development programmes. The problem for Britain was that she could simply not afford to allow these countries to draw down their sterling

39 'Importance of prime minister Robert Menzies’ visit', 11 July 1950, Truman Papers, president’s secretary’s files, Truman Library Missouri. I am indebted to Greg Pemberton for a photocopy of this document.
40 'Notes on economic matters', by J.F. Nimmo, 13 April 1950, CRS A571/1 50/2227 Part 7, AA.
41 'Importance of prime minister Robert Menzies’ visit’, 11 July 1950, Truman Papers, president’s secretary’s files, Truman Library Missouri.
balances; but nor could she persuade the Commonwealth countries to surrender their sterling balances, except in return for dollar aid. The British therefore asked the Americans to embark on a comprehensive programme of aid to South East Asia which would both assist in developing the region as a bulwark against communism and at the same time help to solve the United Kingdom's dollar problem. Independent initiatives by overseas sterling countries to obtain dollar loans would undermine the United Kingdom's overture. The British would also have been worried about the impact of dollar loans on the unity of the sterling area. Moreover Australia might call on the United Kingdom's central reserve for dollars to meet the interest repayments on the loan.

The British Commonwealth foreign ministers' conference at Colombo in January 1950, urged on by Spender, had already begun to organise a coordinated programme of international aid to South and South East Asia. Spender thought that the consolidation of communism in China, and the evident danger of its emergence as a growing force throughout South East Asia, posed a threat to Australian security. He favoured measures which would assist in South East Asia's economic reconstruction, and which would stop the spread of communism throughout the region. The British Commonwealth ministers took the initiative in coordinating international action to deal with the region, because three quarters of the people of South and South East Asia belonged to the British Commonwealth. Spender hoped from the outset that the Americans would participate in the scheme. The United States was giving priority to facilitating economic recovery in western Europe and had always considered South East Asia, with the exception of the Philippines, as a British sphere of influence. The Australian government was hopeful that with the limitations of the Marshall Plan becoming increasingly evident, the United States might deliberately stop the Marshall Plan.

42 'Sterling balances and South East Asia', note by the United Kingdom government, 17 April 1950, FRUS, Volume I, 1950, pp.1637-9.
43 Telegram 3200 Nimmo to treasury, 7 July 1950, CRS A462/1 559/1/4, AA.
44 'Economic policy in South and South East Asia', annexure 4 to the cabinet submission on the discussions at Colombo, 5 January 1950, CRS A461/2 T326/1/4, AA.
Plan, and reconsider the whole question of American aid as a world problem rather than a European one.\textsuperscript{45}

The British wanted to use the Colombo Plan to reiterate to the Americans their view on the importance of triangular trade to the reconstruction of multilateralism. They pointed out that before the war, South and South East Asia provided almost all of the world's exports of jute and rubber, three quarters of the tea, and about half of the tin. Rubber and jute earned dollars in North America; tea and oils were shipped to Europe. In return the industrial products of western Europe – textiles, machinery, iron, and steel – flowed back into the region. The earning of a dollar surplus by South and South East Asia enabled the United Kingdom and the western European countries to finance their dollar deficits. But the dollar earning capacity of the region had been severely injured in the second world war and the United Kingdom was no longer able to provide the steady flow of capital necessary for the region's continued economic development.\textsuperscript{46} The British wanted two things: first, more American purchases from South and South East Asia; and second, direct dollar assistance to the region which would simultaneously reduce the United Kingdom's indebtedness to the sterling countries there. American assistance was essential. For if aid to South East Asia remained a purely Commonwealth affair, Australia might for example make a sterling grant to Indonesia. But this grant would come out of Australia's sterling balances and would be used by Indonesia as a claim on British labour and material. Australia would turn its sterling into goods and services at British expense.\textsuperscript{47}

The process of developing a plan for the economic reconstruction of South East Asia brought home to the Australian government the limitations of the sterling area. Economic development in

\textsuperscript{45} 'The outlook for United States economic assistance in South East Asia', n.d. January 1950, CRS A1838/1 532/5/2/2, AA.

\textsuperscript{46} 'United Kingdom report on economic aid to South and South East Asia', May 1950, CRS A1838/1 708/9/2, AA.

\textsuperscript{47} 'Sterling balances and South East Asia', note by the United Kingdom, 17 April 1950, \textit{FRUS}, Volume I, 1950, p.1639.
both Australia and South East Asia could not proceed from British capital alone. It would depend increasingly on the United States.

The British were trying to negotiate with the Americans a settlement on the sterling balances which would preserve the sterling area. A solution along the lines of Copland’s plan, with overseas sterling countries obtaining American loans individually, building up their own dollar reserves, and diverting their trade away from each other and towards North America, would inexorably result in the break up of the sterling area. They sought to discourage Australia from obtaining a dollar loan and setting a dangerous precedent for other sterling area countries. They were concerned that the Australians might establish new commitments on sterling area reserves for the repayment of the principal and interest of the loan. And they worried about the possible adverse effect of the loan on the amount of ERP aid granted to the United Kingdom. British treasury officials asked Australia’s representatives in London whether Australia’s commitments were so large that they could not be expanded into a slightly larger ‘normal’ dollar import programme – that is, one entirely financed from the sterling area dollar pool. They hinted that if Australia’s needs were modest – about $20 million extra per year – Australia would be allowed to proceed without publicity to increase her annual drawings from the central pool above the ceiling recommended by the United Kingdom.48

The Menzies government went ahead with its plan to obtain a large dollar loan from the United States. Menzies personally made the trip to Washington, stopping in London on the first leg of the tour. He took with him a strong team of advisers – A.S. Brown, and T.W. Swan of prime minister’s, F.H. Wheeler and S.G. McFarlane of treasury, F.A. Meere of customs, and R.G.A. Jackson of national development. In London the Australian government had to justify its new economic policies. At a preliminary meeting of officials, the Australians pointed out to the British that the Australian economy was suddenly on the move. A population increase of 3 1/2 per cent

48 Telegram 3200 Nimmo to treasury, 7 July 1950, CRS A462/1 559/1/4, AA.
per annum was planned for the next ten years, a greater rate than even the United States had ever experienced. Australia had to obtain the resources to match this population growth. The government had three main objectives. First it had to step up production. Delays caused by the shortage of coal and steel had to be eliminated; this would be done by importing, by increasing local productivity, and by expanding public utilities. Secondly, it had to mechanize the rural areas and increase their productivity. Large projects of hydro–electrification and irrigation were being undertaken for this purpose. Thirdly the government wanted to expand the building industry and increase the available housing. An immigration rate of 200,000 per year would alone create an annual demand of 50,000 houses, which was equal to the highest output achieved before the war.49

The British officials said that if the Australian case were put in an economic vacuum, with no political or strategic background, the United Kingdom would argue forcibly against Australia seeking a dollar loan. Why, they asked, should Australia be allowed to incur new dollar liabilities when she was still in dollar deficit and already had loans of $213 million outstanding? And would Australia’s dollar balance of payments improve sufficiently to cover the new loan charges to be incurred? Australia was not using the loan for a programme of industrialisation but would continue to be predominantly a food and wool growing country with markets in the United Kingdom. The high speed development programme might cause a serious inflation. And if export prices fell this would mean that Australia would have to draw heavily on her sterling balances. The Australians replied that an increase in imports would be useful for development and would also be a good counter for inflation. They were bearing the sterling balance problem in mind, arguing that as United Kingdom production increased, the relatively small drawing on these balances should not cause the British any embarrassment. Australia would inevitably suffer balance of payments problems but this had to be ‘set against the expansion which, for strategic and, in a certain sense,

49 Note of a meeting held in the United Kingdom treasury, 18 July 1950, CRS A1209/23 57/5274, AA.
economic reasons’ had to be undertaken at once. The British considered Australia’s seeking of a dollar loan contrary to general sterling area policy but agreed that it would have to be justified by reference to the larger economic and strategic issues involved. 50

On 14 July Menzies held a meeting with Attlee, Bevin, Cripps, Shinwell the minister for defence, and Gaitskell, the minister of state for economic affairs. Menzies explained that the Australian government was reluctant to commit the army component of the British Commonwealth Occupation Force to Korea. He moved on to a discussion of Australia’s domestic problems. Australia had three central domestic problems which were closely inter-related: inflation, immigration, and economic development. For the last three years prices had gone up by about ten per cent per year. To combat inflation the productive effort would be increased – the campaign against communism should have among its effects some increase in productivity – but an annual increase of four to five per cent was the most that could be hoped for. The heaviest pressure was on capital goods – heavy industrial plant, building materials, and equipment for development projects – and on raw materials – coal, iron, steel, and timber. This pressure was increased by the impact of the immigration and economic development programmes: in particular, the Snowy River hydro–electric scheme required a great deal of plant not procurable in soft currency countries.

Immigration into Australia was now at a rate of about 200,000 a year. This imposed an enormous strain on Australia’s economy; but Menzies saw a quick increase of Australia’s population as the only long term solution of Australia’s economic difficulties. The total population had already reached eight million, and was increasing annually by three to three and a half per cent. A long term programme of large–scale development had been worked out. The Snowy River project alone would involve a total outlay of £200 million. For the carrying through of the immigration and development programmes, dollar expenditure could not be avoided. The necessary

50 Ibid.
capital equipment could not be obtained at home, nor could the programmes be financed out of savings and normal domestic resources. The Australian government realised that as a net dollar user Australia must be dependent on the sterling area dollar pool; and they resolved to maintain their policy of buying everything they could from soft currency sources. But dollar equipment had to be obtained in large quantities, and the cabinet had decided that, after full consultation in the United Kingdom, Menzies would seek a dollar loan in the United States. 51 Cripps acquiesced in Australia's decision to seek a dollar loan but emphasised strongly his preference for the IBRD over the Export–Import bank, which was a department of the United States government. Menzies agreed and mentioned that he would be afraid of the political conditions which might be attached to any loan from the Export–Import bank, for example, the commitment of ground forces to Korea or 'acceptance of the draft treaty of friendship, navigation, and commerce to which he and his colleagues were extremely allergic.'52 In a short discussion on economic affairs, Bevin said that he had been concerned for some time about the relationship of Australia with the United States – and with the attitude of the United States towards Far Eastern questions generally. He feared that the United States wished to hurry into a Pacific pact without ensuring that the signatories of the pact were strong enough to make a solid contribution to common defence. 53

Menzies arrived in the United States in late July to find that his cabinet had made the decision without him to send Australian ground forces to Korea. He had high level discussions with the president, secretary of state, and American treasury officials and on 2 August he told Eugene Black, the president of the IBRD, that he needed an assurance that at least $100 million could be provided immediately.54 Astonishingly

51 Minutes of a meeting held at 10 Downing Street on 14 July 1950, CRS A1209/23 57/5274, AA.
52 Ibid., note of a meeting between the prime minister of Australia and the chancellor of the exchequer, 19 July 1950.
53 Ibid., minutes of a meeting held at 10 Downing Street on 14 July.
54 Memorandum of conversation by secretary of state, 25 July 1950, 'Internal development in Australia', FRUS, 1950, Volume VI, pp.205–6; memorandum of conversation by secretary of state, 31
Black immediately informed Menzies that the IBRD was willing in principle to finance Australia's development programme ($250 million) and that it would negotiate at once for an initial loan of $100 million.\textsuperscript{55} Shedden observed that 'it is understood that the assistance rendered to the United States by Australia providing naval, air, and ground forces in Korea has facilitated the consideration of Australia's request for a dollar loan.' \textsuperscript{56} Chifley accused Menzies of making the decision to send ground forces to Korea in order to get dollars.\textsuperscript{57} And in the subsequent budget debate he criticized Menzies' entire dollar policy:

> By borrowing overseas the government will incur, not only a large external debt, but also a recurring interest bill, whilst in respect of plant for the purchase of which such funds are used, there will be a heavy yearly expenditure for replacements... The government will be foolish to load itself down with an American dollar debt.\textsuperscript{58}

Despite the great improvement of the sterling area's holdings of gold and dollars in 1950, the United Kingdom government requested the Australian government to continue to limit dollar expenditure in 1950/1, as it had done in 1949/50, to 75 per cent of Australia's dollar expenditure in 1948. Having campaigned against the Chifley government on the ground that its dollar policy was 'negative', Menzies was determined not to give in to the British as he thought Chifley had. Fadden replied to the British, on behalf of the government, that although he agreed with the need to keep on economizing on dollar imports, he had misgivings about adhering to a formula. Fadden said that he wished to return to the situation prevailing before the emergency of 1949: the United Kingdom would keep on supplying Australia with dollars on demand, as long as the Australian government cooperated with the British in dollar

\textsuperscript{55} 'Prime minister's mission – discussions in the USA', \textit{FRUS}, Volume VI, 1950, pp.206–7; telegram 617 Menzies to Fadden, 3 August 1950, CRS A462/1 559/1/4, AA.

\textsuperscript{56} Pemberton, \textit{op. cit.}, pp.20–1.

\textsuperscript{57} \textit{Daily Mirror}, 7 August 1950.

\textsuperscript{58} CPD, Vol. 210, 10 October 1950, pp.1266–7.
saving and dollar earning measures. In a discussion between Australian and British officials on 20 July, the Australians asked the United Kingdom government publicly to concede Australia’s right to adopt a flexible dollar import policy. The British argued that this would seriously embarrass them, particularly because Australia was seeking a dollar loan on top of wanting not to be bound by a dollar expenditure target. If countries like India knew that Australia was reserving the right to adopt a ‘flexible’ dollar import programme, they would ‘use it as a rod to thrash the UK’. The British asked Australia to continue abiding by the gentleman’s agreement of the 1949 finance ministers’ conference, at least until the next sterling area financial conference. The Australians protested that the British treasury was using such conferences as instruments for managing the sterling area.

The United Kingdom convened Commonwealth economic talks in London in September 1950. McEwen again represented Australia. The United Kingdom government submitted to this meeting a paper which argued that the dollar recovery of the sterling area was due to a combination of the dollar import cuts, which had sterling area dollar imports running at a rate $900 million less than the 1948 figure, devaluation, and the recovery of United States business. It pointed out that, despite this dramatic improvement, the sterling area’s total reserves were still only one quarter what they were before the war. A serious depression in the United States might cost the United Kingdom over one billion dollars a year while it lasted. The United Kingdom’s dollar reserves needed to be two to three times bigger before Britain could even contemplate currency convertibility and relaxing discrimination.

On 22 September Gaitskell set about getting the sterling dominions to agree on a formula for restricting dollar imports into the sterling area. The formula would take

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59 Telegram 3011 Fadden to Harrison, CRS A1838/1 708/12/1 TS, AA.
60 Minutes of meeting at UK treasury, 20 July 1950, CRS A571/2 50/2674, AA.
61 Ibid.
62 Gold and dollar position of the sterling area, C.E.T. (50), 18 September 1950, CRS A571/2 50/2674, AA.
account of inflation and the need of countries to stockpile for strategic or developmental reasons. His motive in trying to introduce this formula, was to place some limit on the dollar expenditure of India and Pakistan. The Australians were furious. Menzies immediately cabled Attlee that he could not understand why the British were attempting to reimpose a formula when ‘there is no question of any renewed dollar crisis requiring emergency action.’ He further objected to having McEwen ‘placed in a position of having agreed in advance at a British Commonwealth conference to recommend to the cabinet some formula the implications of which there has been no opportunity for us to examine.’ 63 J.F. Nimmo reported that the Australian government had acutely embarrassed the British. All the Commonwealth countries except Australia and New Zealand would have accepted a compromise formula, and New Zealand was only waiting for Australia to say the word before she gave in. Because of Australia’s resistance, however, the British were now forced to turn back to gentleman’s agreements to regulate the sterling area’s dollar imports. 64

The Menzies government and GATT

By October 1950 the sterling area’s gold and dollar reserves had risen to about $3000 million. The state department noted the favourable movement in the sterling area’s reserves and recommended the progressive relaxation of the discriminatory import restrictions imposed against the dollar area since July 1949. 65 The United States had the opportunity to press its views at the third meeting of the contracting parties to the General Agreement on Tariffs and Trade (GATT), held at Torquay from October 1950. The Americans persuaded the contracting parties to invite the IMF to make a report on the import restrictions of the sterling area countries. They also persuaded the Fund to make a report on the sterling area countries individually rather than as a unit. The United States wanted to indicate that it did not regard the cooperative dollar policy

63 Ibid., Menzies to Attlee, 23 September 1950.
64 Ibid., Nimmo to Wheeler, 25 September 1950.
of the sterling bloc as consistent with the aims of the IMF or with American foreign economic policy generally. The American decision to bolster the sterling area after September 1949 was a temporary and ad hoc policy. The last thing the Americans wanted was to allow the development of a Commonwealth economic bloc. The United States was helping to shore up the sterling area, in order to assist the United Kingdom’s economic recovery and to speed up its integration into western Europe. The continuation of a discriminatory sterling bloc had no place in the Americans’ scheme of things. Despite British pleas for the legitimacy of the sterling area, the Americans obtained from GATT and the IMF a report recommending the relaxation of import restrictions by the United Kingdom, New Zealand and Southern Rhodesia. 67

The British wanted the United States to bear the burden of the adjustment to international equilibrium. They hoped that at Torquay the United States would grant substantial and in part unmatched tariff reductions as a contribution to the general solution of the imbalance of payments between the sterling area and the dollar area. The United States rejected the British proposal, arguing that the proper solution to the dollar problem was not a unilateral reduction of American tariffs, but the adoption by debtor countries of appropriate domestic and exchange policies, in other words devaluation and deflation. 69

When in opposition, the Liberal and Country parties in Australia had resisted the ITO and GATT and there was some talk that the Menzies government would actually withdraw Australia from GATT. But Canada and the United Kingdom, Australia’s most important preferential markets, were signatories to GATT. Menzies realised that irrespective of whether Australia belonged to GATT or not, no new preferences could

66 Ibid.

67 The Chairman of the United States delegation to the fifth session of the contracting parties to GATT to the acting director of the office of international trade policy, 22 November 1950, FRUS, Volume I, 1950, pp.771-3.


be created in favour of Australia or existing markets increased. Although he disliked the idea of GATT aiming at the elimination of preferences, he appreciated that the contraction of preferences was conditional on adequate compensatory reductions of the American tariff. Moreover Australia would still be entitled under GATT to discriminate against her wartime enemy, Japan. The Menzies government reconciled itself to GATT and moved one step further in its wholesale conversion to multilateralism and to the policy of retreating from the sterling area and forging a new economic relationship with the United States. 70

Before the Torquay tariff negotiations began, the state department pointed out that wool was the most important single item in the tariff negotiations, the key to negotiations with Australia and New Zealand, and from experience, with the British. 71 Nevertheless in November 1950, the United States department of commerce and agriculture tried to recommend a much more limited concession on wool than was suggested by the president. The state department insisted that a more limited concession on wool would wreck the tariff negotiations with the Australians, who had only recently demonstrated their goodwill by agreeing to ‘participate in a set-aside arrangement for wool which is designed to ensure adequate supplies of wool for United States military requirements’. 72 The president agreed with the state department. 73

When the negotiations started, the United States adopted the position that because of the scope of its offer on wool, it expected a substantial list of reciprocal concessions from Australia, particularly in the reduction of preferences for Australian goods in the United Kingdom and Canada. Australia refused, thus preventing the United Kingdom

70 ‘Note on Australia’s position in relation to the General Agreement on Tariffs and Trade and the Havana charter of the International Trade Organisation’, 24 January 1950, fourth Menzies ministry cabinet committee on overseas commercial relations agenda, CRS A 4933/XM1 Volume 26, AA.
and Canada from making tariff reductions which would permit the entry of American primary products into their markets. The American delegation reported that the Australian delegation held the key to the whole conference. If they relented, there was some hope of the United States concluding an agreement with the British Commonwealth which would go some way towards solving the dollar problem. On 26 March 1951 the secretary of state wrote to Menzies complaining of his failure to conclude an agreement, between the United Kingdom and Canada, which would allow them to make concessions to the United States on agricultural products. Menzies replied that the American offer on wool did not warrant concessions from Australia beyond the tariff reductions already made on goods covering thirty per cent of Australia's imports from the United States – machinery, iron and steel plate, fabrics, pneumatic tyres, aeroplane parts and films. The United States thereupon terminated its negotiations with Australia and with the other Commonwealth countries, speculating on a conspiracy of the sterling area countries to maintain imperial preference. The Australian government's stance reflected the fact that because of the enormous increase in the price of wool, the value of the reduction of the American wool tariffs was no longer worth so much.

British Rearmament and the Sterling Area

The Marshall Plan began to wind down in November 1950 when Chinese armies intervened in the Korean war. The Chinese intervention shattered hopes that the Korean war would end quickly and created fear in the minds of American policy makers that communist aggression would lead to the outbreak of war in other parts of the world. The United States increased her defence expenditure according to the prescriptions of NSC–68 and intensified pressure on the western European countries to

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74 The acting chairman of the United States delegation at the Torquay conference to the secretary of state, 18 March 1951, FRUS, Volume 1, 1951, pp.1285–6.
75 Ibid., The secretary of state to the embassy in Australia, 31 March 1951., pp.1304–5.
76 Ibid., The Australian embassy to the department of state, 26 April 1951, pp.1307–9.
77 The Secretary of state to the acting chairman of the United States delegation to the Torquay conference, 3 April 1951, FRUS, Volume I, 1951, pp.1316–7.
expand their military expenditure. As Hogan has shown, rearmament took absolute priority in American policy in 1951, leading first to the transformation of the European Recovery Programme into defence support and then to the demise of the Marshall Plan altogether. American defence production and stockpiling programmes swelled sterling area gold and dollar reserves to such an extent that Marshall Aid to Great Britain was suspended at the end of 1950. But rearmament in the major western nations fuelled inflation and drove up the price of scarce raw materials. The United Kingdom decided in February 1951 to spend a massive fourteen per cent of national income – £4,700 million in three years – on rearmament. The pressure of this massive military spending, added to the difficulty of obtaining scarce and expensive raw materials, led to a balance of payments blow out and another sterling area crisis.

In December 1950 Attlee visited Truman to urge him to stop the Korean hostilities from escalating into a third world war. At this meeting Truman and Attlee decided to set up standing commodity groups which were consumers and producers of particular raw materials in short supply. These groups would make decisions about assembling and distributing scarce raw materials. Later, in January 1951, the Americans, the British and the French agreed to set up a central institution – an international materials conference (IMC) – to which the standing commodity groups would be responsible. The Americans, the British, and the French, dominated the IMC, but other countries were represented on the established commodity committees. Simultaneously the British Commonwealth set up a special liaison organisation with the object of safeguarding the interests of Commonwealth countries like Australia which were not members of NATO or the OEEC. Menzies expressed strong support for this liaison organisation.

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79 Truman–Attlee talks – raw materials, 15 December 1950, CRS A571/2 51/246, AA.


81 Minutes of the eighth meeting of the London prime ministers’ conference, 10 January 1951, CRS A571/2 51/246 Part 1, AA.
On 4 June 1951 the United Kingdom government requested a Commonwealth conference for September to consider supply and production problems. The agenda for the conference included the work of the IMC, a review of the longer term problem of raw material shortages, and a review of the supply position of manufactured and semi-manufactured goods. Menzies sent McEwen to London again. The British explained to the conference that shortages of raw materials threatened to set a limit to world progress. Production was being held back in the United Kingdom for lack of raw materials and this was having an effect on the ability of the developed countries to export capital equipment and other essential manufactures. These shortages were particularly acute during the period of accelerated rearmament. The British saw the solution as increased cooperation to increase the production and stabilize the price of essential raw materials.

The Australian government had no trouble agreeing with most of the British arguments. It did, however, have reservations about international measures to stabilize the price of raw materials. Indeed the Australians suspected that wool was the ulterior motive for the British calling the conference and that the British were trying to surrender control of the price and distribution of wool to the IMC. The government did not want the IMC interfering with wool – Australia’s main foreign exchange earner.

During the period of postwar reconstruction when Chifley was in power, one of Australia’s biggest problems was that the prices of the sterling area’s main dollar earning commodities and American purchases of these commodities were too low. The result was that the whole sterling area was chronically weak and the United Kingdom found it difficult to export capital to overseas sterling countries. From September 1949 to the middle of 1951 the position improved. The United Kingdom’s gold and dollar

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82 UK high commissioner in Australia to Menzies, 4 June 1951, CRS A571/2 51/1516 Part 1, AA.
83 CSP(51)2 General raw materials prospects – meeting of Commonwealth ministers concerned with supply and production, 25 August 1951, CRS A571/2 51/1516 Part 1, AA.
84 Cablegram 156 Menzies to Attlee, 21 August 1951, CRS A462/2 441/2/9 Part 1, AA.
reserves rose from a low of $1340 million in September 1949 to a high of $3867 million at the end of June 1951. Two main factors were responsible for this: the dollar cuts introduced after July 1949 brought down American imports into the sterling area to 70 per cent of the 1948 level; and sterling area exports to North America increased rapidly because of devaluation and expanded American purchases of Malayan rubber and tin, and Australian wool. Australia actually contributed $101 million to the dollar pool in 1950/1.

In the second half of 1951 this situation changed completely. The new chancellor of the exchequer, Hugh Gaitskell, cabled Fadden on 2 August that the sterling area as a whole could expect a dollar deficit of about $1000 million in 1951/2. This was a far cry from the estimated $120 million surplus which the British had only recently given to NATO. Gaitskell explained the downturn as due to increased purchases of North American goods by the United Kingdom and the rest of the sterling area, particularly for defence purposes; and a falling off in the value of sales to the dollar area, particularly of wool, tin, and rubber; and thirdly to sterling area balance of payments deficits with western European countries.85

Gaitskell visited Washington in September 1951 to argue that additional American support would be necessary if Britain were to be rearmed without having to restrict dollar imports, wreck its economy, and once again put the sterling area in danger of breaking up.86 He was not seeking the resumption of Marshall Aid to Britain. He wanted three things: first, a guarantee of regular purchasing and price stability for the sterling area’s main raw materials – wool, tin, and rubber; more American defence aid to the United Kingdom; and American permission for a higher level of trade between eastern and western Europe.87

85 Personal message from Gaitskell to Fadden, 2 August 1951, CRS A571/1 51/1723, AA.
87 Memorandum of conversation by the assistant secretary of state for economic affairs (Thorp), 6 September 1951, FRUS, Volume IV, 1951, pp.961–5; United States minutes of the second meeting of the United States – United Kingdom foreign ministers in Washington on 11 September 1951, FRUS, Volume I, 1951, p.1883.
When Gaitskell returned to England he made the point that the higher level of gold and dollar reserves which the sterling area had built up in 1950/1 provided the United Kingdom with a breathing space to set things right. Even after a sterling area dollar deficit of $638 million in the third quarter of 1951, there was still $3,200 million in the central reserve:

This is a major and fundamental fact which allows us to meet such further deficits as may be inevitable while we of the sterling area take stock with our friends, including our partners in NATO, agree on what has to be done, and resolutely carry out the remedial measures.88

Back in Australia Copland was issuing a renewed call for the establishment of an economic nexus between Australia and the United States which would enable Australia to resist any request from the British to implement ‘remedial measures’ in the interests of the ailing sterling area. He pursued the idea of an agreement between the United States, Canada, and Australia, as a means of easing the British Commonwealth’s dollar problem. The aim of this pact would be to make Australia entirely self supporting in dollars and to permit greater dollar investment in Australia with a view to increasing her production. Copland did not explicitly say that Australia should leave the sterling area – though that seemed to be the logical outcome of his suggestion – but that Australia should redirect her exports from sterling and other soft currency markets to the dollar area. He argued that the sterling area failed to provide Australia with the capital goods which she required for her large scale development, defence, and immigration programmes. Australia should therefore supplement her existing financial arrangements by a special agreement with the United States. This would have as its immediate objective the acquisition of sufficiently large dollar loans to finance the purchase of the required capital equipment. The sting in Copland’s argument was that the Menzies government should refuse to have anything to do with the dollar

88 Speech of H.T.N. Gaitskell, 3 October 1951, CRS A571/2 50/2227 Part 7, AA.
import cutting programme likely to be requested by the British government at the forthcoming Commonwealth finance ministers' conference.89

The *New York Herald Tribune* predicted that Australia might play the critical role in the dissolution of a ‘tottering’ sterling bloc. Ceylon was already accumulating her own dollar earnings, Pakistan had converted her sterling holdings into gold, and India was trying to do the same. The Australian government revealed that it had built up an emergency gold reserve of £44 million after stopping selling gold to the Bank of England for sterling. The *Tribune* thought that by using her annual gold production, plus her emergency gold reserve of £44 million, and by drawing on a new dollar loan, Australia could leave the sterling area and live on her own dollar reserves, if the ties between Australia and the deteriorating pound became weak enough to break. 90

In the United Kingdom in October, Attlee’s Labour government broke up because of disagreements about the pace of British rearmament. The British Labour government was defeated in a general election in October. The new Conservative chancellor of the exchequer, R.A. Butler, confirmed his predecessor’s assessment of the need to call a Commonwealth finance ministers’ conference for January 1952. He cabled Fadden on 8 November that at the present rate, the sterling area might well lose £750 million of its reserves in 1952. He announced that the United Kingdom was restricting imports by £350 million to halt the drain on the sterling area’s reserves.91

In December 1951 the Australian government took a close look at the balance of payments problem. It discovered that there had been a sharp deterioration in the Australian balance of payments which might lead to a drop of £600 million in Australia’s reserves in 1951/2. This was a staggering figure given that Australia’s total

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89 ‘Australia – dollar area link’; report by J.F. Nimmo, 23 October 1951, CRS A571/1 48/322B Part 7, AA.


91 Message from the chancellor of the exchequer (Butler) to finance minister (Fadden), 8 November 1951, CRS A462/2 845/25, AA.
London funds in November 1951 were only £604 million. The Australian balance of payments crisis was an inevitable consequence of the collapse of the wool boom when the Americans ceased buying wool in such vast quantities in the middle of 1951. The wool boom had helped to finance Menzies' national development programme. Wool exports increased massively in 1950 and 1951 allowing Australia to pay for the imports necessary to expand the development, immigration, and defence programmes, as the following table shows:

Table 7.1 – Imports and Exports

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<th>Year</th>
<th>Wool exports</th>
<th>Other exports</th>
<th>Total exports</th>
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<tr>
<td>1948/9</td>
<td>218</td>
<td>311</td>
<td>529</td>
</tr>
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<td>1949/50</td>
<td>300</td>
<td>301</td>
<td>601</td>
</tr>
<tr>
<td>1950/1</td>
<td>626</td>
<td>349</td>
<td>975</td>
</tr>
<tr>
<td>1951/2</td>
<td>320 (estimate)</td>
<td>340</td>
<td>660</td>
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Imports

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<th>Year</th>
<th>£million f.o.b.</th>
</tr>
</thead>
<tbody>
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<td>1947/8</td>
<td>338</td>
</tr>
<tr>
<td>1948/9</td>
<td>415</td>
</tr>
<tr>
<td>1949/50</td>
<td>538</td>
</tr>
<tr>
<td>1950/1</td>
<td>742</td>
</tr>
</tbody>
</table>

92 'The balance of payments problem', cabinet agendum, 3 December 1951, CRS A571/2 51/1723, AA.
93 'Australia's balance of payments problem and international reserves', cabinet agendum, 3 December 1951, fifth Menzies ministry cabinet agenda, CRS A4905/XM1 Volume 9, AA.
Fadden told cabinet that Australia's dollar surplus of $101 million in 1950/1 would be transformed into a deficit of about $160 million in 1951/2. He attributed Australia's worsening balance of payments to the collapse of the Korean war wool boom and to the rise in Australia's imports from the United States and the rest of the world. Australia sold $296 million of wool to the United States in 1950/1 and $289 million in the calendar year 1951, whereas in 1952 she was only estimated to sell $152 million. The treasurer thought that the British would ask two things of Australia: first, to intensify domestic counter-inflationary measures; and secondly, to limit imports from all non-sterling countries. Since Fadden had just introduced his 'horror budget' he was happy to endorse any proposition about curbing inflation in order to protect the position of sterling. 94

But even if counter-inflationary measures stopped inflation completely in Australia, a balance of payments problem would still be there. Australia would always have a balance of payments deficit – an 'import surplus' in contemporary parlance – so long as immigration and defence spending continued on their present course. Indeed having an 'import surplus' was an integral part of Menzies' policy of expanding development, defence, and immigration, without at the same time putting an immense strain on Australia's limited domestic resources. If Australia were to continue to expand her population at a high rate, and to continue her higher rate of defence spending, she would need an import surplus. This surplus could be financed either by running down Australia's external reserves, or by borrowing. But as long as Australia drew on sterling area dollar reserves to finance essential imports from the dollar area and from the OEEC countries, the United Kingdom would demand that Australia make a contribution to diminishing the strain on the sterling area's reserves. Australia would

94 Ibid., 'Australia's dollar position', cabinet agendum, 3 December 1951.
have either to restrict imports from all sources, or to borrow dollars in lieu of making
the import cuts. 95

On 9 January 1952, the chancellor of the exchequer, R.A. Butler announced a
sterling area gold and dollar deficit for the fourth quarter of 1951 of $764 million.
The sterling area's central reserves stood at $2,335 million compared with $3,867
million in June 1951. Sterling area exports to North America were falling and sterling
countries were spending heavily on dollar imports. Australia was at fault, both because
it was spending dollars profligately, and because it had wrecked Gaitskell's attempt to
impose a strict ceiling on the dollar spending of the independent dominions. The
sterling area was also incurring deficits with the OEEC countries which, because they
involved the payment of gold to the European Payments Union, drained the central
reserves. The sterling crisis of 1951 was different from the one in 1949. What brought
the 1949 crisis on was the effect of the American recession on the dollar earnings of the
countries in the overseas sterling area. In 1951 the sterling area was in deficit all
around the world, with the OEEC as well as with the dollar area. There was no solution
to be found in the sterling area importing more from the OEEC than from the dollar
area. The only way out was for the sterling area as a whole to import less and export
more.96

At a meeting of officials on 8 January 1952, prior to the conference proper, the
British delegation sought to emphasise to the other members of the Commonwealth the
benefits of the sterling area system. There had been criticism of the United Kingdom's
use of the overseas sterling area to balance her dollar trade. The Times, for example,
argued that the situation where the rest of the sterling area were paying for Great
Britain's dollar deficit could not persist forever, and that some sterling area countries,
and particularly the colonies, would be seeking greater freedom in spending their

95 'The balance of payments problem', 3 December 1951.
96 'Gold and dollar position', 9 January 1952, CRS A571/2 50/2227 Part 2, AA.
The British used a number of arguments pointing out the benefits of the sterling area system with a number of arguments. The central reserves of the sterling area had been too small after the war to enable member nations to pursue all the trade policies they would have liked, but they allowed more economical and effective use of reserves than if each member tried to maintain reserves adequate to its particular type of economy. The existence of central dollar reserves spread risk. If one sterling area commodity lost ground as a dollar earner, there was much more chance of finding another that would take its place in the whole sterling area than in a single national economy, where most members were dependent on a few staple exports. In 1950 no less than two thirds of import trade and half the export trade of sterling area countries, other than the United Kingdom, was sterling area trade. It was therefore free from the need to be regulated by the arduous bilateral bargaining which had to precede trade between different monetary systems. Capital was completely free to move within the sterling area. Since 1947, the outflow of capital from Britain to the sterling area was slightly larger than the accretion in the sterling balances of the overseas sterling Commonwealth, which were in effect loans to the United Kingdom. So the United Kingdom had been lending to the overseas sterling area slightly more than she borrowed. A final advantage of membership of the sterling area was access to the British market, the second largest in the world. 98

The British used all the arguments which had convinced Chifley that Australia's best interests were with the sterling area rather than the dynamic but unpredictable United States economy. The same arguments failed to convince Menzies. Though Menzies was even more of an Anglophile than Chifley, his election victory in December 1949 had been based on a criticism of 'restrictive' sterling area policies. Moreover his government's foreign economic policy was greatly influenced by the

97 The Times, 23 July 1951. The sterling area consisted both of independent dominions like Australia and New Zealand and dependent, non-self governing 'colonies' like Malaya.
98 The sterling area – note by the United Kingdom delegation FM(52)3, 8 January 1952, CRS A571/2 51/1723A, AA.

Repeating on behalf of the Australian officials, Wilson made some acerbic comments. It would be wrong, he said, to depend on large scale American assistance to the sterling area in the future. The central reserves of the sterling area were so low that sterling countries had to impose harsh discriminations against trading partners, disturbing economic and political relationships. Inconvertibility of sterling was a stigma. Australia had the right to regard her currency as a sound one and did not want to rely on the charity of others. Discriminating in trade in order to protect reserves was self defeating and discrimination against the United States retarded Australia’s development programme. Wilson went beyond the British approach of simply developing a short term programme to respond to the sterling area’s immediate problem. He recommended that the individual sterling area countries agree on a long term policy of balancing their trade and building up reserves in order to achieve convertibility with the dollar. Simultaneously the British Commonwealth should approach the United States for aid, not to shore up the sterling area as a discriminatory bloc, but to speed up the sterling area’s attainment of multilateralism.

On 15 January the finance ministers’ conference began. Butler opened it by requesting the Commonwealth countries to control inflation and restrict imports from all sources. Fearing a critical reply from Fadden, he called on the New Zealand prime minister, Holland, to reply ahead of the Australian finance minister. Fadden was

99 Casey noted in his diary on 12 May 1952 that he ‘did not think it possible to develop Australia adequately with our own resources and that it was essential to get the United States interested in our development and expansion and to get substantial American money invested in Australia.’ T.B. Millar (ed), Australian Foreign Minister: The Diaries of R.G. Casey 1951-60, London, 1972, p.83.

100 Preliminary meeting of officials – ‘Long term problems of the sterling area’, 10 January 1952, CRS A571/2 51/1723A, AA.
'flabbergasted' by Holland's pro-British attitude and put on the defensive, but discussions with Wilson confirmed the soundness of his brief.101 He stressed the need for the sterling area to develop a long term programme to improve the position of sterling. In previous crises the actions of the sterling area had been in the nature of stop-gap measures to ward off imminent disaster. There had been very little action of a kind which promised any fundamental improvement. Australia needed a tremendous amount of capital for development and at present could only borrow from the United States to an insignificant extent. From the point of view of development, and of attracting foreign capital, continuation of the weak position of the sterling area with its recurrent crises would be prejudicial to Australia's future. Short term measures were simply not enough:

As viewed from Australia, the sterling area was at the cross roads: the alternatives were to mould its future intelligently according to our own desires and its basic needs, or to patch it up more in hope than in confidence of success.102

At the second meeting on 16 January, the British decided to fix targets for each sterling area country such that in the aggregate the sterling area would achieve balance with the non-sterling world by the end of 1952. They rejected the idea of uniform import cuts. The method of achieving balance would be at the discretion of each country but would include one or more of these methods: direct import cuts, expanded exports, further deflation, or borrowing outside the sterling area. The United Kingdom asked Australia to convert her predicted deficit of £35 million in the second half of 1952 into a surplus of £15 million.103

Fadden refused to give Butler an undertaking that Australia would try to achieve the target surplus.104 He pressed the conference to adopt sterling-dollar convertibility as its main objective. When a senior British treasury official suggested that

101 Fadden, op. cit., p.126.
102 Minutes of the first meeting of the Commonwealth finance ministers' conference, 15 January 1952, CRS A571/2 51/1723A, AA.
103 Cablegram 263 Fadden to Menzies, 16 January 1952, CRS A571/2 51/1723 Part 1, AA.
104 Ibid., cablegram 262 Fadden to Menzies, 16 January 1952.
convertibility should not be adopted even as an ultimate objective, Fadden became very suspicious. He feared that the British government actually preferred to see the sterling area continuing indefinitely as a limited convertibility system hedged about with discriminatory controls against goods from other non-sterling countries and especially from the dollar area.\textsuperscript{105}

The conference concluded at the end of January. Fadden had succeeded in avoiding a commitment on his part to 'recommend to government a series of measures or even a particular target'. He was obliged only to lay before the Australian government proposals which were discussed at the conference. The conference had in fact not committed Australia to any particular method of working out its own salvation although it had suggested – over Fadden's contention that it was not practicable – a particular target at which Australia should aim. Fadden told Butler that Australia would try to achieve as much of this target as possible by borrowing and expanding exports.\textsuperscript{106} Butler told Fadden that he was nevertheless relying on the Australians to take firm action on the sterling crisis. He added that if the crisis worsened in the immediate future, he might have to propose the rationing of dollars and other non-sterling currencies throughout the sterling area.\textsuperscript{107} Fadden not only resisted taking the medicine given him by the British, he also persuaded the conference to agree to prepare a plan to restore convertibility.\textsuperscript{108}

Fadden reported back to cabinet on 4 March. He told his colleagues that the critical tone of many of the other members of the overseas sterling area was entirely in harmony with Australia's views. He recalled that when in opposition, the Liberal and Country parties had condemned a policy which seemed to rely on restriction of dollar imports as the principal method of solving the dollar problem. That policy was self

\textsuperscript{105} Cablegram 304, Fadden to Menzies, 19 January 1952, CRS A462 845/25, AA.
\textsuperscript{106} \textit{Ibid.}, cablegram 366 Fadden to Menzies, 24 January 1952.
\textsuperscript{107} \textit{Ibid.}, cablegram 338 Fadden to Menzies, 22 January 1952.
\textsuperscript{108} \textit{Ibid.}, Fadden to Menzies, 21 January 1952.
defeating. The more tightly imports from non-sterling countries were restricted, the more Australia was denied access to the great producing areas of North America – resources which were indispensable to Australia's development:

unless we and other countries in the sterling area can develop our resources and expand our earning power there can be no hope of breaking through the net-work that has enmeshed us since the war, and we must resign ourselves to live indefinitely within a largely closed system which appears to become more narrowly constricted with each successive crisis.  

Fadden argued that the weakness of sterling stood in the way of the government's bid to avoid the need for a controlled economy: the sterling area system prejudiced Australia's ability to acquire the foreign capital necessary for her development.  

There was no doubt that the drain on Australia's reserves which had set in from the middle of 1951 was dangerous. Indeed the *Manchester Guardian* alleged that an 'Australian buying spree' was responsible for the sterling area crisis. Fadden recommended that 'as a paramount objective of policy, we must aim to avoid any further net loss of reserves in 1952/3'. The government had gone as far as it could in financing imports from external reserves. Now it had to contrive to bring expenditure on imports into line with Australia's external resources – export income plus borrowing. Fadden did not think that the price of wool would yield an export income much above £584 million in 1952/3. As for borrowing overseas, there was little chance in Britain where the limited available funds were being spent on the defence programme, internal investment, and the colonies. Borrowing in the United States was also difficult. Only the IBRD was a strong bet, and only an extra $150 million was possible. So Australia's ability to buy imports was largely limited to her export earnings. The abruptness in the change in Australia's capacity to import was not surprising seeing that the import boom in 1950 and 1951 was made possible by two factors. The first was the wool boom in 1950/1 where Australia's export earnings had increased by £375 million in one year. The second factor was the enormous build up in

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Australia's sterling balances between 1947 and 1951, when imports from the dollar area were tightly controlled, speculative capital was flowing into the country, and Australia was making unrequited exports to western Europe. This added up to £580 million in five years. Had Australia been limited in 1950 and 1951 to her normal export earnings, the country would have been forced to afford much less by way of imports, and the government would have been forced to apply all round import cuts much earlier.\(^{111}\)

The solution of the Commonwealth finance ministers to the sterling area's problem was for sterling area countries to cut imports from non-sterling sources so as to restore equilibrium to the balance of payments. Since Australia now had trade deficits with virtually all countries, the quest for remedies to the sterling area's problem linked neatly with Australia's particular problem. From Australia's point of view it was necessary to cut imports by half to a total of £500 million, and from the sterling area's point of view Australia had been set a target of achieving a surplus in her balance of payments. The government introduced massive all round cuts on imports from all sources, including the United Kingdom. The Menzies government had come to power on a programme of ridding Australia of unnecessary 'socialist' controls. It had been successful in this because of American rearmament and the recovery of the sterling area in 1950/1. But the wool boom collapsed, the terms of trade turned against Australia, and British rearmament pushed the sterling area into another crisis. The Australian government had no alternative but to resort to stringent import controls, introduced belatedly in the face of the collapse of Australia's external position.

**Menzies' Economic Talks in the United States and the United Kingdom in 1952**

\(^{110}\) *Ibid.*

\(^{111}\) 'Australia's balance of payments and international reserves', cabinet agenda 214, 4 March 1952, fifth Menzies ministry cabinet *agenda*, CRS A4905/XM Volume 9, AA.
The Conservative government in Britain was uncertain about how to approach the sterling–dollar problem. In the early months of 1952 Butler pushed a plan codenamed 'Robot'. The gist of it was to block about eighty to ninety per cent of the sterling balances, while allowing the remainder and subsequent additions to be freely convertible at a rate left to find its own level and thus relieve the strain on reserves. Critics of the scheme argued that the strain on the United Kingdom’s reserves would mean a burden on the economy in the form of higher interest rates, higher prices, and higher unemployment. The Conservative cabinet rejected Butler’s plan. 112 The Australian government had no knowledge of the ‘Robot’ debate. As far as it was concerned Butler’s policy was indistinguishable from that followed by his socialist predecessors. 113

The British government was distressed that the Australian import restrictions applied to British goods as well as to those of other countries. They affected the textile trade in Lancashire particularly badly, causing dislocation and unemployment. In April 1952 prime minister Churchill asked Menzies to come to London for general discussions. The British prime minister’s main purpose in calling the meeting was to persuade Menzies to mitigate the effect of the Australian import cuts on British industry. The Australian cabinet secretary, A.S. Brown, argued strongly to Menzies that it would be undignified for him to be ‘summoned like a schoolboy to London to explain himself and then to do what he is told’. He added that the United States was bound to regard any relaxation of restrictions against the United Kingdom as discrimination against themselves and that this would affect Australia’s chances of getting money from them. ‘These fellows are very tiresome but, of course, they have the cash’. Australia’s ultimate objective was to forge a new economic relationship between Australia and her two great allies, the United Kingdom and the United States.

113 Cablegram 288 Fadden to Menzies, January 1952, CRS A571/2 51/1723, AA.
He advised Menzies not to go to London immediately, but to wait and make the trip there after first visiting Washington.114

Menzies visited Washington from 16 to 21 May. In his economic discussions he told the Americans that Australia needed military supplies in order to be able to contribute expeditionary forces to the wider western defence effort in the minimum possible time. This was a difficult problem because of Australia’s growing pains from a rapid population increase and the need for a major development programme. The Australian government had plans to send eight or nine squadrons to the Middle East. But the cost of the equipment for the squadrons was $200 million. Australia did not have these dollars and the IBRD did not lend for defence purposes. Menzies hinted that the Americans should provide Australia with grant-aid under their mutual defense assistance programme (MDAP) for the purchase of jet fighters. The American secretary of defense replied bluntly that Australia could not receive this equipment unless she paid for it, notwithstanding Menzies’ resentment that Indonesia received grant-aid. America’s priorities in military aid were Korea and Indochina. 115

Menzies moved on to London in June. He told the British cabinet that Australia could not afford to grant significant concessions to British traders, since the purpose of the import restrictions was to preserve Australia’s financial reserves. He would only concede that cases involving special hardship, particularly the exclusion of goods made specially for the Australian market, should be dealt with sympathetically, though that might mean exceeding the target limit for Australian imports by a few million pounds. He was adamant that the British should not pressure Australia progressively to relax the restrictions on imports from Britain, because this would offend the Americans. The Commonwealth secretary suggested that a conference should be held in January 1953 to develop a united Commonwealth policy on economic and commercial matters.

114 A.S. Brown to R.G. Menzies, 9 April 1952, CRS A1209/23 57/5055, AA.
Menzies replied that the economic situation and the need to develop a united Commonwealth policy on economic issues was so urgent that the conference should be held in November 1952 and attended by prime ministers. 116

The United Kingdom government accepted Menzies' proposal and from July 1952 onwards the Australian government set about determining its attitude to the crucial question of which way Australia should go economically. Should it choose the option of a 'super-Ottawa', signifying a closing of the economy of the British Commonwealth or should it choose immediate exchange convertibility in the sense of complete freedom of exchange transactions between sterling and non-sterling countries? The debate was conducted between an anti sterling area group including McEwen, Fadden, and treasury secretary Wilson, and another group, one of whose members was the the prime minister, which retained a sentimental attachment to the British Commonwealth.

The treasury produced some reports extremely critical of the sterling area. It argued that the sterling area system had only survived because of outside aid, such as the American loan and Marshall Aid, and by temporary circumstances such as the stimulation of the devaluation in 1949 and the boom in raw materials following Korea. The sterling balances of member nations had of necessity been frozen and they had been forced to impose discriminatory trade and exchange controls. Because of these controls sterling nations were denied anything but the most restricted access to the North American market, and were forced to draw their supplies from limited and more costly sources. This tended to retard their development and force up their internal prices and costs. Industries within the sterling area supplying the sterling area were sheltered from dollar competition. And because sterling area countries were expanding industries in order to replace cheaper dollar imports, they were developing uneconomically and diverting resources away from sounder more natural

116 Conclusions of a meeting of the British cabinet at 10 Downing Street, 17 June 1952, CRS A1209/23 57/5055, AA.
development. Treasury argued that the sterling countries should be incorporated into a multilateral system. To achieve this objective, American assistance would have to be obtained. If the Americans were to come to their aid, three conditions would have to be met. They would have to be convinced that the sterling area had abandoned the policy of discriminatory self-sufficiency which it had pursued since the war. They would want to assist the sterling area not by direct aid, but rather by investing more in the sterling area. And finally they would want to be convinced that the sterling countries individually were prepared to pursue internal and external policies which would give them a chance of standing on their own feet.  

External affairs warned Menzies that any departure from the objectives of non-discrimination and free convertibility would arouse hostility in the United States and have political as well as economic repercussions. The British Commonwealth needed American political and military assistance in Europe, the Middle East, and South East Asia. Taking measures to turn the sterling area into a protected trading bloc would hinder the administration's efforts to lower the American tariff, and prejudice programmes of economic and military assistance to Australia and other parts of the Commonwealth. External affairs argued that Australia should play a leading part in recommending the strategy that the Commonwealth should adopt in dealing with the Americans. A clash with the Americans would be averted if the Australian objective of pressing for the resumption of convertibility gained acceptance.

J.G. Crawford, secretary of the department of commerce and agriculture, advised Menzies that there were strong arguments against a closed British Commonwealth. The Commonwealth was rich in potential resources but needed outside capital to develop them. It could not escape world trading problems since it had great surpluses of wool, rubber, and minerals, which it needed to sell to the United

117 'Basic sterling area policy', 2 September 1952, CRS A1209/42 57/5919 ATT, AA.
118 'Cooperation with non-Commonwealth countries', external affairs brief for Menzies at the Commonwealth economic conference in November 1952, n.d., CRS A1209/42 57/5919 ATT, AA.
States, and great needs of other products, such as cotton, petroleum, and wheat which needed to be imported from North America. In a closed sterling area trading system, Australia's sales to the United Kingdom might be improved, but imports into Australia would cost more. Finally the British Commonwealth could hardly expect Canadian, United States, and European support, if a discriminatory economic policy were vigorously pursued. 119

Brown concurred, advising Menzies that one of the largest obstacles to the conference was that the British Commonwealth could not provide capital for its own development:

From this it follows that unless capital can be obtained from somewhere else the development is not likely to go on and the conference instead of opening the way to an era of expansion may well close the way to development or alternatively come to no decision on the point.

The British Commonwealth needed at least £500 million a year for development and the United Kingdom could only provide £250 million. Australia could not be developed at the rate the Menzies government wanted without foreign capital. The only source of foreign capital, on the scale that Australia needed, was the United States. A closed British Commonwealth would not allow Menzies to have his development and defence programmes.120

At the Commonwealth economic conference in November, the Australians argued strongly for a long term plan to achieve convertibility and multilateralism. Menzies argued that the existing relationship between sterling and the dollar could not last. The central reserves of the sterling area were weak, sterling was weak, and there was a shortage of capital. The Commonwealth had to develop a positive plan to enlarge its reserves, not by American aid but by increased foreign investment in the sterling area. The conference eventually decided on a plan called the 'collective approach' to

119 'Economic policy conference - notes by Crawford on discussion with treasury officials', 16 September 1952, CRS A1209/42 57/5919, AA.
convertibility. Sterling countries would curb inflation, encourage development, and run surpluses on their balance of payments in order to build up reserves. An essential part of the plan, as Menzies observed, was the participation of the United States by encouraging investment in the sterling area and by consistently buying sterling area products. The collective approach was designed to achieve convertibility and abolish discrimination. If successful it would mean the end of the sterling area, the end of Australia's economic dependence on Britain, and the beginning of a new relationship with the United States.121

Conclusion

When the Menzies government assumed power in December 1949, Australia was in the midst of an acute dollar crisis. In the absence of a comprehensive agreement to work together to solve the dollar problem between Britain and America, there was no solution to the problem in sight. But the Liberal and Country parties had campaigned against Labor's policy of restricting the importation of dollar goods, particularly petrol. In government they embarked on a programme of increased defence preparations, immigration, and development. This programme could not fail to be inflationary unless there was a huge import surplus. An import surplus would increase Australia's indebtedness overseas and run down the reserves which Chifley had built up as a bulwark against depression. Luckily for Menzies the economic discussions between Britain, America, and Canada, in September 1949 bore unexpected fruit. The United States reversed its policy of immediately dismantling the sterling bloc, and agreed to take measures to shore it up. The British and the Americans reached an agreement on petrol which allowed the abolition of petrol rationing. And more importantly, the United States stepped up her purchases, first of Malayan rubber and tin, and later of Australian wool. The sterling area's reserves were replenished, and Australia even contributed $101 million to the dollar pool in 1950/1.

121 Minutes of the Commonwealth economic conference C.E.C. (52) 3rd meeting, 1 December 1952, CRS A1209/42 57/5717, AA.
The Menzies government took steps to end Australia's dependence on an ailing sterling area. Menzies put Australia's economic development on a new course by securing a dollar loan over British opposition. And in September 1950, McEwen opposed the idea of Australia adhering to a dollar import target set by the British. The government relinquished many controls over the economy and continued with its national development programme. It was able to do this because of the change in the international environment. American rearmament, the wool boom, and the build up of Australia's London funds between 1947 and 1951 gave Menzies the means of expanding development without running into balance of payments problems - at least until the end of 1951. He was able to reconcile the contradictory goals of damping down inflation and speeding up development, and he was able to avoid an economic crisis that could have been fatal given that he did not control the senate.

When American purchases of raw materials returned to more normal levels in the second half of 1951, the British rearmament programme brought on another sterling area crisis. This was not so much another 'dollar' crisis as a sterling area balance of payments crisis with the rest of the world. The Menzies government's response was not sympathetic. Fadden and Menzies thought that a weak sterling area was retarding Australia's defence preparations and development. They sought to break the cycle where the sterling area suffered intermittent crises followed by intensified import restrictions, by urging the development of a plan to bring about pound–dollar convertibility, and a multilateral relationship between the sterling and dollar worlds. Fadden championed this idea at the finance conference in January 1952 as did Menzies in his visits to Britain and the United States later in the year.

The dollar shortage and fear of depression drove the Labor government to adopt policies which protected the sterling area. The Menzies government did not fear depression and was not disposed to look favourably on the sterling area. For the Menzies government the sterling area was a strait jacket restricting Australia's development and defence preparations. Unlike Labor, the coalition did not think that
the threat of war was remote. With no fear that inflation would get completely out of hand and weaken Australia’s defences against depression, Menzies pursued a policy of expanded development and war preparations. He opposed the import restrictions and rationing associated with the protection of the sterling area as ‘socialist’, and promised to abolish economic controls. The main difference in the economic policy of the Chifley and Menzies governments was not so much a disagreement about the degree of government ownership of industry and banking, as a disagreement about whether the economy should be controlled in order to avoid depression or freed up in order to speed up development. He was able to do so because American rearmament stopped the 1949 dollar crisis turning into a depression and prevented the sterling area system from breaking up. After the sterling area crisis of 1951, Menzies reintroduced stringent import controls. They were not, however, designed to protect the sterling area as a discriminatory economic bloc. Because the sterling area could not provide capital for the development of Australia and South East Asia, Menzies decided definitely in 1952 that Australia would retreat from the sterling area in favour of a new relationship with the United States.
CONCLUSION

The main aim of the Chifley Labor government during postwar reconstruction was to establish Australia's economic security. In the early years of the war it had decided that international economic collaboration afforded Australia the best means of avoiding depression in the years after the war. The Labor government signed article VII of the mutual aid agreement, and thereby signalled its readiness to participate in the multilateral world order which the United States was trying to construct. It agreed to participate in the process of reducing tariffs and barriers to trade and to surrender some of its economic sovereignty to a new world monetary organisation. However, this government did not see its adoption of multilateralism as an abject surrender to the economic hegemony of the United States. It thought that more good would come from multilateralism than from sticking with the pre-war system of economic regionalism and protectionism. In view of the fact that the Australian economy was particularly dependent on trade, Australia would benefit from the expansion and diversification of world trade. The Australian government was inclined to be supportive of international collaboration provided that the Americans interpreted multilateralism to include positive measures to stimulate world trade and employment as well as the simple removal of barriers to trade. The opposition parties opposed multilateralism as a threat to British Commonwealth economic unity.

The Chifley government’s acceptance of multilateralism was in fact conditional on the Americans taking active steps to maintain full employment and to remedy the dollar shortage – the chronic imbalance in world trade caused by the disruption and devastation of the Second World War. Australia joined the International Monetary Fund in 1947 and signed the General Agreement on Tariffs and Trade, but it had the right to withdraw if at any stage it thought that these multilateral organisations were failing in the task of maintaining full employment. Moreover Australia could always fall back on a sterling area which could go one of two ways: it could be incorporated slowly and with proper safeguards into a multilateral world order or it could form the
basis of a British Commonwealth autarky independent of the United States. In the convertibility crisis of 1947, when the United Kingdom was sinking under the weight of the multilateral obligations imposed on it in 1945 by the Americans, the Chifley government sought Australia's salvation with Britain. It cooperated with Britain in reneging on multilateralism, and re-establishing the sterling area as a discriminatory economic bloc. With the whole process of building a multilateral world failing, the Australian government opted to stick with the weak yet stable sterling area, rather than seeking to forge a new economic relationship with the dynamic yet unstable United States economy.

After the convertibility disaster and with western Europe on the brink of economic ruin, the Americans adopted a new strategy to bring about the desired goal of multilateralism. The United States would provide massive dollar aid to western Europe during a limited four year period. In return, western Europe would integrate itself economically and increase its production so as to lessen its dependence on American goods. Moreover the United Kingdom would be detached from its economic association with the British Commonwealth and the sterling area would be dismantled. In this way the 'free' world would move step by step towards multilateralism. The United Kingdom government immediately perceived that this plan had two fundamental faults. First, it argued that the dollar shortage would not be solved simply by increasing the production of western Europe. Even if western European production were restored to pre-war levels, trade between Europe and the United States would not balance. This was because Europe traditionally financed a deficit with the United States by earning dollars through trade with underdeveloped countries in the Far East. In Britain's case she financed her dollar deficit by trading with colonies like Malaya which earned a dollar surplus by selling rubber to the United States. Secondly, the British argued that the dollar shortage was not caused by the failure of Western European production in particular but by the failure of the production of food in the world as a whole. This made the rest of the world more dependent on supplies from the
United States. The British solution to the dollar problem was therefore to provide dollar aid to countries outside western Europe and particularly those in the overseas sterling area.

The circumstances of the inception of the Marshall Plan, and the formation of the North Atlantic Treaty Organisation, left the Chifley government in an invidious position. The central plank of the its foreign and defence policies was support for the United Nations. Now the authority and the legitimacy of the United Nations was being challenged by the existence of two rival economic and military blocs: the Soviet bloc on one side and an American–western European alliance on the other. The Australians would have no influence whatsoever over the strategic policy of the North Atlantic Treaty Organisation. And NATO policy would be directed against the likelihood of war with the Soviet Union to the detriment of the settlement of a peace treaty with Japan which would secure the security and stability of the Pacific. But, in the minds of Chifley's ministers, this foreign policy aspect of Western Union was only secondary to the economic aspect. If Australia had in the future to face up to the blizzards of another depression, she would be left out on a limb, with America continuing to resist importing from the rest of the world, and with her major trading partner, the United Kingdom, deserting the sterling area and joining an integrated western Europe.

From the end of 1947 on, the Chifley government concentrated its domestic and foreign policies on preparing Australia for depression. It sought assistance for Australia from the European Recovery Programme and endeavoured to increase trade within the sterling area and to lessen its dependence on the United States. The endeavour to nationalise the Banks was one outcome of the Labor government's depression mindfulness. It was initiated so that the Commonwealth would have unfettered control of the money supply, and control of domestic sources of capital investment, in case overseas sources dried up and the dollar area proved out of bounds to Australia. Contrary to one widely held view, this attempt at nationalisation does not provide a sufficient explanation for the Chifley government's fall from power; in fact
Labor had largely recovered from the debacle by 1948. The continuation of wartime controls, the failure of these controls to curb inflation, and the discrimination against dollar goods undertaken to shore up the sterling area's declining reserves between 1947 and 1949 were perhaps more important causes of Chifley's fall. The unpopularity of dollar import restrictions began a transformation in the policy and ideology of the coalition parties – from opponents of multilateralism and supporters of a British Commonwealth economic bloc to critics of a weak sterling area and advocates of a new economic relationship with the United States. When the high court found commonwealth petrol rationing to be unconstitutional in June 1949, the coalition hung their opposition to the Chifley government's sterling area economic policy on the issue of petrol rationing.

The Chifley government ran large immigration and development programmes without borrowing on a large scale from abroad. Since essential goods from North America had been deliberately restricted since August 1947, the strain of excess demand on the limited supplies available in Australia produced an inflation rate of about ten per cent per year in the Labor government's last years. And when Britain and the dominions devalued sterling in September 1949, giving further impetus to inflation, the opposition parties cried out for the need to put value back into the Australian pound. This slogan had two corollaries for the Menzies government: first, that inflationary pressure could be alleviated by creating an import surplus, revaluing, and borrowing dollars; and secondly, that Australia's economy and trade, and capital flows, should be reoriented to avoid a too close dependence on a declining sterling area.

Because demand was burgeoning at the end of the 1940s at the same time as there were severe shortages caused by Australia's inability to get supplies from hard currency sources, and because of the inadequacy of Australia's own coal production, the Chifley government had to put a lid on the demands of Australian trade unions for increased wages. The Labor government's regulation of wages prompted some trade
unions to try to bypass the arbitration system by direct bargaining on basic conditions of work. The coal strike of 1949 was a dispute in which the unions’ advocacy of direct bargaining and the right to strike conflicted with the government’s determination to have industrial problems settled by conciliation and arbitration. The presence of communists in high positions in the coal mining unions which waged the three month long strike prompted the Liberal and Country parties to advocate the banning of the Communist Party. The coalition parties emphasised throughout the coal strike and the 1949 election the harm that the Australian Communist Party was doing to Australia’s preparedness for war. This was in direct contrast to the Chifley government’s main concern that the coal strike was harming the position of the sterling Commonwealth and increasing Australia’s vulnerability to a depression spreading from overseas.

The transition from the Chifley government to the Menzies government was a change from a government driven by fear of depression to a government afraid of the outbreak of war. This change occurred in a period of crisis. In 1949 the United States was suffering a mild recession which many commentators were predicting would turn into a depression. The American recession had a disastrous effect on the sterling area, despite the assistance of Marshall Aid. The sterling area’s reserves of gold and dollars fell below what the United Kingdom government considered to be the minimum safe level. The whole sterling area system was in danger of disintegration and there was talk in the highest levels of the Australian and British governments of abandoning multilateralism and forming a non-dollar trade bloc. The Chifley government fully supported the United Kingdom in this second sterling area crisis and moved to reintroduce petrol rationing. Ironically the coalition parties abandoned their imperial patriotism and campaigned against what they saw as the Chifley government’s uncritical support for ‘socialist’ Britain. The Menzies government assumed power at a time when the dollar shortage, with all its implications for the international economy, was at its most critical stage. The resolution of this problem depended entirely on the
degree of economic cooperation which America would give to Britain and the dominions.

Luckily for the newly elected Menzies government, the Truman administration took active steps in 1950 to solve the dollar problem along lines which the Chifley government had consistently argued for in the 1940s: as well as continuing foreign aid and loan programmes, the Americans would have to buy from the rest of the world as much as they sold. The Americans now agreed to do for the sterling area what they had done for western Europe. They agreed to abandon the idea of imposing multilateralism on the sterling area until it could build up enough dollar reserves to withstand the full rigour of equal competition with the dollar area. Until then, the Americans would acquiesce in sterling area regionalism. The sterling area would remain a limited convertibility system hedged about with restrictions against dollar competition. And in the meantime, the United States would take active steps to increase its purchases of sterling area raw materials like Malayan rubber and tin, and Australian wool. When the Korean War broke out in June 1950 the United States began to spend a massive amount of dollars in sterling countries in South East Asia and Australasia, a trend which reinforced America’s new foreign economic policy. In Australia an American inspired wool boom increased Australia’s earnings of dollars and in the sterling area as a whole, dollar reserves in the middle of 1951 were double what they were in September 1949.

Simultaneously the Menzies government was departing from the pro-British economic policy of its predecessor. One of its first decisions was to abolish petrol rationing. This was a source of strong contention between Australia and Britain, until the American oil companies unexpectedly reached agreement with the United Kingdom government in the middle of 1950, an agreement which enabled Britain to de-ration petrol throughout the sterling area. The Menzies government refused to consider itself bound by target figures for imports from North America set by the British, and had no hesitation in cutting across British efforts to secure a
Commonwealth wide agreement with the United States over the sterling balances, to obtain a dollar loan from the United States in August 1950. When the terms of trade finally turned against the sterling area at the end of 1951, precipitating another Commonwealth crisis, the Australians were markedly critical of the sterling area. Instead of meekly accepting the dose of import cutting medicine prescribed by the British, the Australians pushed a reluctant Britain towards accepting the attainment of convertibility within a specific period as ultimate objective of the British Commonwealth. The coalition parties in government were now fully embracing the American doctrine of multilateralism.

The Chifley government had tried to restrain the inflationary boom at the end of the 1940s because it thought that this boom would make Australia more vulnerable to depression. The Menzies government was not at all influenced by this fear. It pursued a policy of increased national development – more defence, development, and immigration. Inflation would be alleviated by deliberately producing a surplus of imports over exports which would help to soak up the increased pressure of demand. The government was enabled to have an import surplus or balance of payments deficit in 1950 and 1951 without having to borrow large amounts from overseas or to attract much greater foreign investment. This was because Australia gained a huge amount of foreign exchange from the wool boom; because Australia still had a great deal of freedom in drawing down the sterling balances; and because it could also draw on the resources of the $100 million loan from the International Bank. Domestically, the problem was how to finance the defence and development programme without sending inflation out of control. The government toyed with the idea of revaluing the Australian pound but because of intra-party disagreement, shelved the idea. In 1950 it imposed a special tax on the woolgrowers to finance the deficit gap in the budget. Labor critics held that this was actually more inflationary than simply leaving the inflated wool cheques in wool growers’ hands. In 1951 the government sought to
control inflation by the ‘horror’ budget. In fact the restoration of economic stability had more to do with external factors than with Fadden’s budget.

The problem of the dollar shortage was gradually being overcome, the sterling area preparing to enter into a system of multilateral trade, and the prospect of depression becoming increasingly less likely. Fear of war in the minds of Menzies’ ministers came to replace the fear of depression in the Labor government. Evatt had discounted the possibility of war in the late 1940s. In the London Commonwealth prime ministers’ conference of 1946 he explicitly criticized the framing of military and strategic policy with Russia as the designated enemy rather than in accordance with the principles of justice and the United Nations Charter.

The Chifley government developed its defence policy in the light of these principles. So far as Australia’s participation in the defence of the British Commonwealth was concerned, it was the Labor government’s view that this could best be done in the Pacific. As the chill of the cold war spread across the world, the United Kingdom government tried to persuade the Australian government to abandon its localized defence policy and to throw off its dependence on collective security through the United Nations. The British government wanted the Chifley government to agree to the United Kingdom’s membership of an anti-Soviet Western alliance – the future NATO. In other words it wanted Australia to approve of a British decision which explicitly recognised the failure of the United Nations to guarantee security and which posited the likelihood of war with the Soviet Union. The British wanted Australia to cease regarding the Pacific as its only theatre of war, but instead to make a military commitment to the defence of the Middle East, which was the British Commonwealth’s responsibility in the event of a global war. They wanted Australian assistance against communist insurgents in Malaya, and against a possible Chinese Communist attack on Hong Kong. The Chifley government resisted all these initiatives.

The adequacy of the Chifley government’s foreign and defence policies became an issue in the 1949 election campaign. The coalition parties promised to strengthen
Australia’s defences and its relationship with the United States and the United Kingdom. They promised to reintroduce compulsory military training and to increase Australia’s preparedness for war. And a short time after it assumed office, the Menzies government introduced a bill to ban the activities of the Australian Communist party, an action which it regarded as a defence measure and a weapon against inflation. The Menzies government wanted to adjust Australia’s economy and war effort so as to be able to participate in the strategic plans of the United Kingdom and the United States against the communist enemy. In June 1950 the new government made a qualified commitment to the defence of the Middle East, but emphasised that the degree of Australia’s participation in the Middle East would depend on American strategic plans in Asia and the Pacific. In September 1950 the government changed the conditions of service in the Army to allow regular and reserve army units to be sent overseas. And it established a national security resources board to assist the government in placing the Australian economy on a semi-war footing. It moved to increase its powers over the economy under the defence power, just as its predecessor had attempted to do in the interests of preserving full employment. And in March 1951 Menzies urged the absolute necessity of being prepared for war in three years.

After the Chinese intervention in the Korean war in November 1950, it seemed possible that the United States might extend operations in Korea, thus beginning an Asiatic or even a global war. British Prime Minister Attlee went to Washington in December 1950 to dissuade Truman from any rash action. And in the Commonwealth prime ministers’ conference in January 1951 he sought to enlist Commonwealth support for a policy of restraint in the Far East. Attlee tried to convince the Commonwealth to concentrate its defence effort on the Soviet threat to Western Europe and the Middle East, rather than wasting its forces in a disastrous war in the Far East. Instructed by the Australian cabinet, Menzies stressed that although American Far Eastern policy might be wrong, the Commonwealth could not afford to break with the Americans on its China policy. The Australian government was at the
time negotiating a Pacific security treaty with the United States which it did not want to jeopardize. When the treaty was finally negotiated, the Americans got a pact which secured the support of the Pacific dominions for a soft peace treaty with Japan and which they hoped would induce Australia and New Zealand to commit themselves to the Middle East. The pact would not be such as to involve military planning between Australia and the United States for the defence of South East Asia. This was in fact what Australia wanted: access to American global planning to ensure that Australian interests in the Pacific were not sacrificed in the interests of fighting the Soviet Union first in other theatres.

In December 1951 the coalition government finally made a military commitment to the Middle East, but remained uneasy that the British might let Malaya fall to the communists in a global war. In order to meet this commitment the Menzies government had quadrupled defence expenditure. The new government had reversed Chifley's policy of neutrality in the cold war and brought Australia into the fold of the western anti-communist alliance. It had constructed a new political and economic relationship with the United States and resolved on a policy of breaking away from the sterling area. The transition from Chifley to Menzies was a change from a Labor government whose policies were directed against the danger of depression to a coalition government whose policies were to prepare for the possibility of a global war against communism, to develop Australia at a much faster rate, and to make Australia less dependent on the sterling area which seemed to restrict these aims.
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