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Failure to heed lesson of the flu pandemic

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In 1920-21, as the influenza pandemic that had cost 15,000 Australian lives drew to an end, the nation turned inwards. Compared with the rest of the world, Australia had been spared, with a death rate barely half Britain's. But coming after a war that had reduced much of Europe to rubble, that made the blessings of isolation seem only so much greater.

Already, the Diggers who had been repatriated – some severely maimed, many injured, all scarred by the long, bloody, fear-gripping years of war – desperately craved a return to normal life. Their ideal now was to preserve what they already were and already had, among people as like as possible to themselves.

"Australia is safe," prime minister Billy Hughes reassuringly said; but if it was to remain a safe haven, it needed to be "inoculated" from the world's pathologies – pathologies that included persistent global turmoil and the threat of renewed conflict.

Securing the country was as much an economic challenge as it was political. Financed largely through loans, the war had increased the commonwealth government's debt from insignificance to 50 per cent of gross domestic product; adding in the states, which had financed the nation's infrastructure and borne the brunt of the pandemic's costs, the total debt to GDP ratio stood at a perilous 130 per cent.

Crippling inefficiencies compounded the risks. After many vicissitudes, Justice Henry Bournes

Higgins's decision in 1907 instituting a "basic wage" came to fruition in 1921, pushing real minimum wages up by 35 per cent in three years and triggering a steep rise in unemployment rates for the unskilled and disabled veterans.

At the same time, the pressure to protect the manufacturing industries that had expanded during the war resulted in the Customs Tariff Act of 1921, which increased the average duty by nearly 10 percentage points, provoking demands from farmers – whose input costs had skyrocketed – to themselves be protected through compulsory marketing schemes and other forms of "protection all round".

Last but not least, far from appeasing the unions, which had grown to cover about half the workforce, wage rises and higher protection emboldened them, with the incidence of working days lost to disputes at levels not seen again until the 1970s. In turn, constant stoppages undermined productivity, so that productivity levels in manufacturing, which in 1911 comfortably exceeded those in Britain, fell below them.

Yet instead of tackling the distortions directly, the dominant belief was that they could be cured by growth. A bigger economy would make public debt manageable, allow manufacturing to exploit economies of scale and ensure full use of infrastructure. With the economy lifting itself by its bootstraps, greater size would, in other words, shrink the inefficiencies into insignificance. And by attracting an ever larger population – of up to 100 million people, claimed Edwin Brady's immensely popular Australia Unlimited (1918) – the country would command a defence capability "that world opinion would either respect or fear".

Achieving all that required, in the famous words of Hughes's successor Stanley Melbourne Bruce, "men, money and markets": men to settle underpopulated areas; money to service those areas with infrastructure; and markets to buy what they produced. "Every thinking Australian," Bruce declared, "recognises that it is imperative in the interests of our national safety that we rapidly increase our population and develop our resources"; and thanks partly to an agreement with the British government providing cheap loans for development schemes and migrant resettlement, immigration and infrastructure spending soared.

At least in the short run, the approach seemed a brilliant success: from 1920 to 1925, annual GDP growth averaged a blazing 6.3 per cent, albeit off a depressed base. That allowed the ratio of public debt to GDP to stop rising, despite the fact government investment accounted for half of total capital formation – a ratio 10 to 15 percentage points above that in the Menzies era, when investment risk fell largely on shareholders rather than taxpayers.

In reality, however, the growth spurt was not due to the influx of migrants or the public spending spree: it reflected surging wool and wheat prices, which boosted the terms of trade and funded a rise in imports (and hence in Customs duties) that helped stabilise government finances. Once export prices peaked in 1926-27, and started on a sharp decline, it became apparent that the outlays whose stated objective was to bolster the economy's growth potential had been squandered on projects that would never recover their costs.

Bruce had argued "there must be a thorough and impartial investigation of every scheme before it is approved"; but the mechanism he established to vet public investment, the Development and Migration Commission, lacked the skills and authority the task demanded.

As for the states, instead of tightening their spending criteria, the flood of inexpensive loans induced them to accept very poor quality proposals, with NSW, to take but one example, trebling the maximum annual loss it was willing to bear on new rail projects. Meanwhile, the state's Main Roads Board, although it recognised that planning and evaluation were desirable, plaintively concluded that "this would involve time and expense", distracting the board from its urgent duty, which was to build more roads.

As a result, despite a few worthwhile projects, such as the Sydney Harbour Bridge (which, extremely unusually, had been subjected to rigorous economic appraisal), each dollar of loans financed assets that, on average, were worth less than 50c. But after the projects were completed, the debts remained to be repaid – and the inefficiencies that stymied the economy's long-run performance remained too. When the reckoning came, the illusions that had guided policy made it all the more painful and prolonged.

Bruce, a man of outstanding abilities, thought that by placing the highest priority on growth he was fortifying Australia as a safe haven in an uncertain and rapidly fragmenting world.

Instead, by ignoring the dangerous level of public debt, facilitating the proliferation of poor quality government spending, and leaving in place – where he did not worsen – existing inefficiencies, he made it more vulnerable to the risks Australians desperately wanted to avoid.

As the exaggerated confidence of "Australia Unlimited" turned to anger and despair, Bruce himself, along with many others of his generation, pondered what had gone wrong.

In a country that specialises in forgetting what it should remember, and remembering what it would do better to forget, those lessons, and the caution they ought to inspire, have faded away. But perhaps, were he here, witnessing the return of so many old illusions, he would say simply this: I have seen the future – and it failed.