A Road Not Taken? Economic Ideology and the Articulation of Policy Alternatives in Irish State Economic Policy-making, 1948-1958

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Bachelor of Arts in Politics and Public Administration

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Abstract

This study examines the fiscal policy positions of five of the most influential economic advisors and policy-makers of the Irish state during the period 1948-1958 through the lens of the policy positions they assumed during a series of the most important event points of that period. This is in order to explore the articulation of competing policy approaches to fiscal policy in the years before the publication of T.K. Whitaker's *Economic Development* study (Department of Finance, 1958). Using a case study approach composed of a series of key fiscal economic event points, the policy positions of these five influential actors are analysed to firstly determine whether alternative diagnoses of the main events studied were proffered by any of the five individuals, as well as whether policy alternatives were articulated by any of these individuals. The study also attempts to categorise the economic philosophy behind each individual's policy contributions, with special emphasis on determining the ideological leanings of T.K. Whitaker's economic philosophy and its similarity/dissimilarity to the traditional position of the Department of Finance utilising extensive archived government documentation supported by in-depth secondary source analysis.

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Declaration

I hereby declare that this dissertation is entirely my own work, in my own words, and that all sources used in researching it are fully acknowledged and all quotations properly identified and fully referenced both (in-text) and in my completed reference list / bibliography. This body of work has not been submitted, in whole or in part, by me or another person, for the purpose of obtaining any other credit / grade. I fully understand the ethical implications of my research, and this work meets the requirements of the Faculty of Arts, Humanities and Social Sciences Research Ethics Committee.

SIGNED: __Frank Fitzgerald__________________

DATE: _____17/02/2022______________________

Introduction

The early postwar period spanning from 1948-1958 was not only one of unparalleled change for the Irish state economically and politically but also one with many parallels to our own. Politically it saw the 15-year unbroken run of Fianna Fáil governments ended by the election of the First Interparty Government. In economics, it saw a move towards a more expansionary state that invested in public housing and hospitals, a programme funded in large part by Marshall aid funds and external asset repatriation, which involved the repatriation of UK-deposited sterling assets held either by public institutions like the Central Bank or the Department of Finance (its departmental funds), or through the commercial banks' subscription to government loans (Ó Gráda, 1997).

The period also saw two balance of payments crises, one in 1952 and another in 1956, where Ireland's external assets were being worn down at a faster rate to pay for increasing imports, even as productive exports were stagnant. Each crisis necessitated – contemporary policy makers believed - a period of "deflation" using budgetary measures to reduce demand for imports through increased internal-facing tariffs to make imported consumer products more expensive and by reducing public expenditure to reduce excess incomes being used to buy more imported goods (Ó Gráda & O'Rourke, 2021). These measures would lead in both cases to crippling recessions, which heightened already-high unemployment and suppressed economic activity by throttling demand (Honohan & Ó Gráda, 1998).

The latter half of this period is famous for the publication of influential long-time Department of Finance civil servant and then-department Secretary T.K. Whitaker's *Economic Development* study, in 1958 (Department of Finance, 1958). The traditional narrative depicts *Economic Development* as a watershed; prior to its publication, this narrative suggests, the political establishment had no viable fiscal-economic policy, and any move towards

expansionary or at any rate "modern" Keynesian thought of a less constrictive hue was stifled by the conservatism of Whitaker's predecessors at Finance, Joseph Brennan and J.J. McElligott.

This is depicted as a two-sided paradigm: The conservative faction on one side, represented by individuals like Brennan and McElligott, who inhibited Keynesian thought in the Department, and "the more radical Keynesian views of a younger generation led by T.K. Whitaker", Patrick Lynch, Louden Ryan and others (Fanning, 2009; Honohan & Ó Gráda, 1998, p. 10), who came into their own as the decade progressed, these older figures moved on, and a dynamic new Taoiseach, Seán Lemass, took on board their new, revolutionary ideas, leading to the "golden age" of the 1960s driven by the ideas espoused in *Economic Development*.

By this account, however, *Economic Development* in terms of fiscal policy represented a departure from nothing, to something, and – in the case of many accounts such as Garvin (2004), McCarthy (1990) and Fanning (1990) a departure from conservative classical thought to radical Keynesianism, as the Honahan and Ó Gráda quote cited above neatly illustrates. In the first instance it does not take sufficient account of the presence of radical developments in Irish economic policy in the early 1950s, such as the introduction of the capital budget concept into national budgeting from 1950 onwards (which involved the separation of capital spending under a separate heading from current spending to legitimise state investment funded through borrowing) or more generally the expanding nature of the public capital programme of public investment introduced in 1950, to cite just two examples.

These initiatives in the first half of the ten year period 1948-58 saw the state move from borrowing to cover nothing larger than tiny routine annual budgetary overruns to spending tens of millions of pounds (growing every year) funded from Marshall aid and the repatriation of

external assets (Barry, 2009). This predates Whitaker's *Economic Development*, but yet is a decidedly Keynesian-inspired advance in its emphasis on state investment to spur economic growth (Lynch, 1998). Was Whitaker in favour of these early Keynesian moves? Further, how can his stance on the need to focus solely on productive projects be understood in the context of the Department of Finance's early opposition to the public capital programme; and also what was his own stance?

Further, though the accepted narrative draws a rough classical-Keynesian dichotomy, it does not explore whether differences of economic ideology existed between these younger figures – whether some in this group were of a more classical economic persuasion while others were more Keynesian in their perspective. For example, T.K. Whitaker and Patrick Lynch, himself a former Department of Finance officer and later economic advisor to Taoiseach John A. Costello, as well as Louden Ryan, a Trinity College economist - are tied together inexorably in existing accounts as two sides of the same ideological coin, but were they? Did they always advise the same thing? How these debates – between Keynesian and classical economic adherents – would have played out in a uniquely Irish context is not fully explored.

This study has three main aims. Firstly, it sets out to examine the positions and policy advice offered by each of the key players analysed during each critical juncture. These are the economists Patrick Lynch, Louden Ryan, and Charles Carter (from Queens University Belfast), who each served on the 1956 Capital Investment Advisory Committee; the economist and parliamentary secretary to the Second Interparty Government John O'Donovan, and Department of Finance civil servant T.K. Whitaker, as well as the two main financial institutions of the state, the Department of Finance and Central Bank.

Secondly, it aims to locate the philosophy of each of these five individuals to categorise whether their philosophies were more Keynesian- or classical-inspired. Thirdly, it sets out to

determine during each event point whether a coherent, theoretically-viable policy alternative (or even simply an alternative prognosis of the situation facing policy-makers) was mooted by any of the key actors studied.

As is discussed in the following lit review, subsequent retrospective quantitative analyses conducted by accomplished economic analysts of the decisions made at the time are frequently critical of the approach taken during the event; Kennedy and Dowling (1975) and Kennedy et al (1988) argue what could be considered a more Keynesian analysis of the problems facing Irish policy-makers. They posit predominantly that, unlike Whitaker's assertion on the need solely for *productive* investment, for them, public investment-led economic stimulus (even when spent on social infrastructure) was empirically the best way to spur economic growth. As such, they actively ascribe blame to the budgetary cuts during the 1952 and 1956 crises for the economic recession that collectively damped economic activity across the entire decade.

Cormac Ó Gráda and Kevin O'Rourke (1997; 2021) also criticise the fixation with the balance of payments on the part of the public authorities, positing that the trade deficit would have righted itself with time. They too make a similar argument about the need for a developing country to consistently maintain a higher rate of investment (productive or otherwise) in order to develop. For this reason this study attempts to contrast these retrospective analyses with the contemporaneous assessments to ascertain firstly what differences may have existed in economic understanding at the time versus retrospectively. It also highlights that the arguments of the time, when compared in the light of the retrospective arguments, are not especially Keynesian, especially in their fixation with balance of payments issues.

This study is composed of four chapters. Chapter One will review the existing literature on the economic situation and the state's economic policy preferences from 1948-58, while Chapter Two sets out the methodology and rationale for the study.

Chapter Three begins the substantive research element of this study during the first half of the timespan studied, 1948-1952. Using a case study approach three key event points are analysed to elucidate the positions taken by the five key actors during each event. These are Ireland's decision to accept Marshall aid; the decision in 1949/50 to split the national accounting budget system to include a "capital" budget for national investment and the subsequent public capital programme; and finally the 1952 balance of payments crisis. Oft-cited in the literature as an early exemplar of their Keynesian "double-act", Patrick Lynch and T.K. Whitaker's respective contributions to the Statistical and Social Inquiry Society of Ireland's 1945 Discussion on Full Employment will also be evaluated to ascertain their positions (Walsh & Whelan, 2010, p. 6).

The fourth chapter concludes the research of this study by examining two pivotal event points for the Irish economy between 1952 and 1956. These are the 1955 decision for the first time to maintain Irish bank interest rates at existing levels to reduce financing costs for enterprise even as the UK raised its interest rates; the 1956 balance of payments crisis, during which the same problems of excessive imports led, contemporary policy-makers believed, to similar problems to those experienced during the 1952 crisis of Ireland's external assets rapidly being drained down to cover the import-export deficit. Whitaker's 1954 paper, 'The Finance Attitude' and his celebrated 1956 paper, 'Capital Formation, Saving and Economic Progress' will also be analysed in order to highlight the continuities between the ideas he expressed mid-decade with those he had espoused in 1949.

Chapter 1 - Literature Review

Trade Policy

A wide range of authors have explored and analysed Ireland's transition from economic protectionism, which is often the focus of studies of the period and the effects of *Economic Development* (Department of Finance, 1958). It is depicted primarily as the point when the political consensus around trade/industrial policy shifted away from protectionism towards free trade and membership of the nascent European Economic Community. Walsh and Whelan (2010) for example argue that Whitaker's ideas on trade liberalisation were inspired by Harvard developmentalist economist Albert Hirschman's theories – for example on primary-secondary industry linkages – which they suggest were disseminated within the Department by Whitaker's association with Louden Ryan.

Barry and Daly (2011) dispute Walsh and Whelan's conclusions, arguing that there isn't sufficient evidence to link Hirschman's ideas, and that initially Whitaker was opposed to the Export Profit Tax Relief scheme fearing erosion of the exchequer revenue intake. Meanwhile Breen and Dorgan (2013) argue that the interests of agriculture in avoiding being shut out of existing markets hastened the dismantling of protectionism and that an ostensive absence of anticipated opposition from industrial interests facilitated this.

Economic Development and The "Big Bang" Narrative

In terms of studies of Ireland's economic policy of the time, the conventional narrative of the 1950s, according to, for example, Fanning (1990; 2009) and Garvin (2004) depicts Ireland's economic fortunes up until the publication of *Economic Development* as a time of gloom and despair about Ireland's capacity to sustain itself. This McCarthy (1990) puts down to a combination of political inertia, which he ascribes to the relatively high electoral turnover of governments in the 1950s, paired with the inherent conservatism of key political figures, like Seán MacEntee, whose 1952 deflationary budget was "disastrous". This manifested itself

in a lack of coherent economic ideas of any describable ideology or form and a tendency on the part of Ireland’s politicians to blame the effects of British rule for Ireland’s economic fortunes (Fanning, 2009).

Economic Development (1958) is depicted as the watershed moment that singularly transformed this otherwise-barren economic policy landscape, leading to the relative economic prosperity of the 1960s, propelled by the “Keynesian” ideas outlined by Whitaker’s study, heralding what is often termed the Lemass-Whitaker era (Fanning, 2009).

Though there is less focus on the alternatives available to tackle these crises, most retrospective quantitative analyses have agreed with McCarthy on the disastrous nature of the measures taken in 1952 and 1956, judging that in each case the balance of payments would have self-corrected with time (Irish Times, 2021; Ó Gráda, 1997; Ó Gráda & O'Rourke, 2021; Kennedy & Dowling, 1975). Whitaker’s role in drafting that budget in these accounts, and his congratulations to MacEntee for his “courage” in taking that course is neglected, however, focusing instead on the ostensibly radical ideas he later developed in *Economic Development* (Chambers, 2014; Murphy, 2009).

Within this, Keynesian thought is represented as being introduced into Irish policymaking with the publication of *Economic Development*, O’Mahony (2021, p. 65) observing that “Keynesian influence is evident in the attitude to state intervention underpinning *Economic Development*”.

This narrative acknowledges the opposition of older Central Bank and Finance figures like Brennan and McElligott to the early-decade Keynesian expansionary initiatives like the capital budget principle and the introduction of the public capital programme. However, it does not address whether T.K. Whitaker and Patrick Lynch – the chief advocate for the two initiatives – actually aligned in their policy positions on these initiatives.

Moreover, although the 1952 deflationary budget is considered a "conservative" and sometimes reactionary non-Keynesian initiative, Whitaker's role in this budget (which he drafted) is not contrasted with his views on the earlier initiatives, nor compared to the ideas he later espoused in *Economic Development* (Department of Finance, 1958).

Other authors, like Murphy (2009, p. 320) depict Whitaker's role as changing from being positioned in the "deflationist camp" in the early 1950s to moving towards a more expansionary, Keynesian stance after 1953. However, this transition is not fully elucidated. It is represented in Murphy's view by *Economic Development,* but it is unclear whether Whitaker's core views had changed so much as his approach to communicating his ideas had evolved. Given that the 1956 balance of payments crisis, which was dealt with using the same heavy-handed budgetary deflation as the 1952 instalment, occurred basically a year before Whitaker began initial work on *Economic Development* (in 1957), Whitaker's position has to be compared across these two crises to understand whether a change really had occurred.

An Alternative Narrative

However, there is also a second established narrative. Represented by contributions like Brownlow (2010) and Barry (2009), these more recent accounts have reinforced the sense that the traditional narrative around *Economic Development* as the epoch-making moment in Irish economic policy of the time needs to be re-examined. Brownlow (2010) argues that Whitaker's philosophy was not Keynesian, pointing to his frequent dismissal of a Keynesian multiplier effect for spurring economic growth and contrasting his focus on savings as the core prerequisite for economic development with the traditional Keynesian concept of the "paradox of thrift".

He also points to Whitaker's focus on the balance of payments, which he says Whitaker prioritised over an activist, expansionary Keynesian demand-management approach, and

observes that Charles Carter's views aligned with Whitaker's from the mid-1950s onwards. However, he does not explore the presence/absence of an emphasis on savings in the writings of Carter, or of the other two economists on the Capital Investment Advisory Committee. Whether Whitaker's emphasis on savings was a Department of Finance concept prior to his 1956 paper, or whether the Department's overall outlook differed from that of its most illustrious servant in its diagnosis of the economy are not explored.

Specialist Quantitative Accounts

It is widely understood via empirical analyses published as recent to the event as Quinn (1969) and others such as Ó Gráda (1997) and Daly (2016) that not only were the core targets of *The First Programme for Economic Expansion*, focusing on agriculture, not achieved, but social investment, which Whitaker advocated be curtailed, was, as Barry (2009) has shown, in fact increased. They also point out that the inevitable recovery trajectory of the economy after the previous deflationary bout in 1956 (by which time Whitaker was secretary of the Department, his role in which is little-discussed) just as likely produced Ireland's "golden age" of the 1960s.

Moreover, bearing in mind that the divergence in fiscal policy in the 1960s implies an alternative approach to Whitaker's philosophy not only existed but was pursued, a more thorough examination of the policy positions taken by the key economic actors in government circles during the 1950s is thus warranted.

Chapter 2 - Methodology

Approach and Sources

The approach taken in this study involves the use of a case study approach, defined by Gerring (2016, p. 28) as "intensive study of a single case or a small number of cases which draws on observational data… to shed light on a larger population of cases". This approach is

utilised through the selection of several of the most important economic decision-making points faced by Irish policy-makers during the period from 1948-1958. These were selected on the basis of firstly representing a clear point of importance where the decision eventually taken clearly influenced the state of the economy and also – more importantly – because of a clear influence the decision had on the state's economic policy going forward.

Through this method the study firstly attempts to establish during each event whether alternative, competing *diagnoses* of the problem or situation were proffered and whether alternative *policies* were mooted. Secondly the study classifies the positions of the five key actors chosen for this study as expressed in their published works and, where applicable, in their contributions to the decision-making process via archival documentation to determine whether each held a philosophy that was more Keynesian, expansionary in origin or alternatively a more classical economic creed.

Keynesian thought is focused primarily on the need to maintain aggregate demand in the economy, even if this requires state investment-channelled demand-management. For Keynesians, the priority is more so on "combating unemployment than about conquering inflation" (Library of Economics and Liberty, 1999). Meanwhile, classical (and later monetarist) thought, in contrast to Keynesianism, contends that monetary stability and thereby a focus on monetary policy to maintain this, was the priority, with a concomitant belief that state-led fiscal expansionism was merely a recipe for economic damage and spiralling inflation (Library of Economics and Liberty, 2005).

The categorising of economic ideology in this study is pursued through focusing on the key components of each man's diagnosis of the main dynamic elements shaping the economy (such as, for example, demand and the role of idle resources like labour and capital), and also by analysing the stated ends of each actor's policy recommendations (for example whether the

actor advocated a Keynesian multiplier-type initiative during an economic crisis, or whether they rejected the utility of expansionary stimulus tools or a general Keynesian analysis of economic activity). If the latter, it suggests their economic philosophy was informed by more classical than Keynesian influences (Library of Economics and Liberty, 1999).

Each event is analysed to assess the positions adopted by the key actors, who were chosen predominantly based on three criteria, firstly upon their having an economic qualification; secondly upon having a clearly-discernible pathway to influence government policy, and finally on the basis of their retaining this influence across an extended period, making it possible to explore their stances across a consistent timespan.

Chapter 3 - Changing Tides, New Ideas: 1948-52

The Marshall Plan

In 1948 the United States would introduce a massive financial aid programme intended to support the reconstruction of Europe. Known formally as the European Recovery Programme (ERP) and more commonly as the Marshall Plan, sixteen European nations would eventually receive grant and loan aid before it ended in 1952, having disbursed $12 billion (Whelan, 1992).

The Central Bank and Department of Finance were initially opposed to Ireland's participation, citing, as they frequently would going forward, concerns about the inflationary effect of domestic circulation of Marshall funds. They feared (not necessarily unreasonably) that Marshall aid would simply cause higher volumes of non-essential goods imports from the dollar area, further destabilising Ireland's balance of trade (Whelan, 1992).

From 1948 onwards, with the ascent to office of the First Interparty Government, Minister for Foreign Affairs Seán MacBride proposed using Marshall aid funds for a programme of mainly agriculturally-oriented investment including land reclamation and

livestock expansion, as well as fishing and mineral resource development. He strongly urged pushing to secure Marshall aid in grant rather than loan form, as was the general government position (Whelan, 1992).

In June 1948 MacBride's position inverted somewhat relative to the Department and Central Bank. After the British Treasury had closed Ireland's access to the sterling-dollar conversion pool (through which Ireland, its currency pegged to sterling, purchased goods from the rest of the world) three months early, the Department of Finance changed its tune, with McElligott now declaring that Ireland was as well "bagging all we could now" (Documents on Irish Foriegn Policy, 2014).

His concern was that "[although] to take a loan might prejudice the possibility of a reasonable grant allocation in future quarters… Not to take a loan… would be inconsistent with our stand against drawing on the Sterling Area Pool". In addition, "any reluctance… to accept… the proffered loan for the current quarter, might cause unfavourable reactions from the British… [in] the trade negotiations" (Documents on Irish Foriegn Policy, 2014). The Department's position was therefore largely focused on external considerations, centring on the British reaction. MacBride, on the other hand, argued that Ireland should still attempt to hold out for grant aid, even at the risk of losing ERP funds altogether (Documents on Irish Foreign Poliy, 2014). In the event the aid was accepted in loan form (Whelan, 1992).

The Department's view as to the ERP's uses and limitations aligned with Whitaker's position. This he summed up in a 1949 memorandum for the minister for finance intended to be considered for cabinet circulation as a policy document. In it he echoed the Department's position that it was worth securing "all the dollars we can" to invest in importing essential capital plant and import commodities such as wheat and tobacco (Department of Finance, 1949, p. 27). At the same time he warned against using it for domestic state capital investment, stating

the view that "…schemes financed from the Fund should…. be revenue-earning" in order to justify the repayment charges that were accumulating from the Marshall Plan funds being received in loan rather than grant form. This essentially precluded their use for social investment (Department of Finance, 1949, p. 27).

He was wary of utilising it for large-scale state capital investment in any form, observing that the use of Marshall aid "for any domestic purpose at all is inflationary" because it adds "to the volume of active money in exactly the same way as if credit were created for the Government by the banking system". This will "increase the pressure on… supplies of… [consumer goods]" which is "diverted to imports" to satisfy the domestic demand for those goods, in turn "causing a realisation of external assets" (Department of Finance, 1949, p. 28).

This is the core Department of Finance/Central Bank objection to increased public spending as well, and, as will be seen going forward, was in a more summative form Whitaker's diagnosis of the causes of the later 1956 balance of payments crisis, which thus makes it a clear continuity in his (and the Department's) economic ideology.

The Public Capital Programme

The government ultimately viewed Marshall aid as a source of funding for public capital investment, and would far exceed the parameters the state's financial mandarins had laid out for accepting and utilising the funds.

Meanwhile, in 1949 as he had advocated for five years previously in his contribution to the Statistical and Social Enquiry Society of Ireland's Discussion on Full Employment in 1945 (which will be discussed later), Patrick Lynch, now economic advisor to Taoiseach John A. Costello, precipitated the introduction of the concept of the capital budget to the budgetary process, whereby long-term state investment ("capital") expenditure was separated in the budgeting process from "current" day-to-day government expenditure to legitimise large-scale

government capital investment (Lynch, 1998). This in-turn represented the impetus for the public capital programme, which invested in social amenities like hospitals and public housing and would continue to expand for most of the next twenty years, into the Lemass era (Barry, 2009).

Lynch later outlined the views he had incorporated into Costello's speech to the Institute of Bankers in November 1949, where the Taoiseach laid out the government's plans for the public capital programme. "…chronic underinvestment" was the cause of Ireland's underdevelopment, Lynch later wrote of his 1949 views. He advocated the "reinvestment of part of [Ireland's external assets] in Ireland" using the capital budget as a "mechanism for repatriation of sterling through a deliberately contrived deficit in the balance of payments" which would "[improve] productive output at home, providing… housing accommodation and improving health services" while "the current budget should [still] be financed from taxation" (Lynch, 1998, pp. 133-134)

Whitaker would take a different view to Lynch. In his 1983 book *Interests,* he described the inclusion of "development expenditure which added to employment… [and] improved amenities… even though it did not yield a *direct money dividend sufficient to offset the corresponding debt charges*… [emphasis added] [as] an ominously liberal concession" (Whitaker, 1983, p. 85).

This was also the standard by which the Central Bank and Department of Finance judged whether spending was appropriate, as represented in the Central Bank's annual reports, which consistently reiterated the "inflationary" effect of public spending on the balance of payments (the amount received as national income from exports versus the amount paid out to cover imports); the need to depend on "current", domestic savings rather than "past" savings in the form of external assets, and in this connection the urgent necessity to reduce taxation. It

also at this point frequently cited the "productive investment" prerequisite for any state spending, made famous eight years later by *Economic Development* (Fanning, 1978; Whitaker, 1983, p. 85).

Whitaker's position and that of the Department contrasted with Lynch's. At the time they were sceptical that external asset repatriation-driven Keynesian stimulus automatically led to economic development, with Whitaker observing that the "import surplus may… merely… increase consumption" without a "net increase in capital investment" which, due to inadequate availability of domestically-produced consumer products at home resulted in growing consumer import volumes, which led to the rundown of external assets to pay for them. He therefore highlighted the importance of the "ordinary budget of the state… [being] balanced" (Department of Finance, 1949, p. 17). This, as expressed as early as 1947, was the underlying diagnosis by Whitaker and the two financial institutions of both balance of payments crises that would arise in the 1950s. The bottom line for Whitaker when it came to fiscal policy at this point (as he again expressed in his celebrated 1956 paper 'Capital Formation, Saving and Economic Progress' eight years later) was that,

> We are drawing on the accumulated savings of the past… [to fund] our capital programme… sooner or later, capital requirements and current savings will have to be brought into line, preferably… by an expansion of current savings, but failing this, by a curtailment of capital expenditure
>
> (Department of Finance, 1949, p. 11).

This statement not only represents the views in-embryo that would later be described as a "radical departure" when he espoused them in his celebrated 1956 paper a full seven years before that paper's publication (Chambers, 2014; Fanning, 1978). It also makes clear that he anticipated no automatic Keynesian multiplier effect from capital spending – which refers to the core Keynesian tenet that government investment will lead to output growth equal to a relative multiple of the original amount invested – unlike Lynch.

There was no guarantee, Whitaker argued, that external asset repatriation-driven investment automatically led to *productive* investment, defined as investment that produced goods or services saleable for a profit, or suitable for export – a standard which the Department and Central Bank echoed and which presages the enshrinement of this criterion in *Economic Development* eight years later (Central Bank of Ireland, 1951, p. 9; Department of Finance, 1949; Department of Finance, 1958). Instead Whitaker advised the government to cut direct taxation to reduce the burden on entrepreneurship and incentive to work and instead focus on maintaining balance of trade equilibrium by avoiding capital investment-induced inflation (Department of Finance, 1949, p. 32).

In the event the capital budget concept facilitated the drafting of the state public capital programme of long-term investment in infrastructure and social investment such as housing and hospitals. The overall public capital programme was funded by a combination of Marshall Plan funds and external asset repatriation (Kennedy, et al., 1988).

This represented a momentous change in Irish economic policy, which predates *Economic Development* by eight years. While the original Fianna Fáil programmes of social investment from 1933 onwards relied on continuously increasing direct taxation, in deference to the advice of their financial mandarins, Ireland's external assets (which only dramatically accumulated during the war years anyway) were not utilised (Barry, 2009). From 1950 onwards the capital budget legitimised this repatriation, which, alongside foreign borrowing during the Lemass era onwards would form the bedrock of the storied investment in social infrastructure of that time, especially the vast social housing construction programme so often referenced as a potential model to resolve today's housing crisis (Ó Gráda, 1997).

Economic Development was produced in large part as a response to the policy context that these earlier initiatives from the start of the decade (which, as shown, Whitaker resisted

but Lynch spearheaded) engendered in national policymaking – that study's famed exhortation to avoid the "wasteful use" of external reserves to fund social investment "in excess of current savings" had no meaning outside of the context of their use to fund the public capital programme and Whitaker's belief that this was the root cause of the recurrent balance of payments crises, a statement which itself was originally asserted in his 1949 memorandum (Department of Finance, 1949; Department of Finance, 1958, p. 16).

The "Double-Act": Lynch and Whitaker as Keynesian Pioneers

In the existing literature, T.K. Whitaker and Patrick Lynch's written contributions to journals and other publications of the time represent an important benchmark for defining the tenets of their economic philosophies. It is therefore worth temporarily diverging from the key decision-making events to analyse these contributions – especially Lynch and Whitaker's respective contributions to the 1945 Statistical and Social Inquiry Society of Ireland (SSISI)'s Discussion on Full Employment (Lynch, et al., 1945) and Whitaker's 1954 paper, 'The Finance Attitude' (1954).

In the existing literature the two men are portrayed as a "double-act" whose mutually Keynesian economic philosophy first revealed itself in the two men's respective contributions to the SSISI's Discussion on the Problem of Full Employment, responding to the ideas of William Beveridge in the UK (Chambers, 2014, p. 71; Walsh & Whelan, 2010).

In his contribution, Lynch (then a young Department of Finance civil servant) postulates that, "a proper direction of the Irish economy will imply increased State intervention… What will be needed to develop a policy of full employment is controlled and planned State intervention" including the formal adoption of the separate capital budget concept to legitimise capital investment – five years before its adoption by the Interparty Government (Lynch, et al., 1945, p. 439).

However, upon closer inspection Whitaker focused his contribution on essentially making redundant Beveridge Keynesian thinking in Irish circumstances, arguing that Beveridge's ideas were "not completely applicable to this country" anyway. State spending-induced inflation can be "checked by direct controls" but "psychological factors" and "the public reaction" to "inflationary-public finance" influence "private decisions whether or not to invest", and so the points of advantage in government expenditure versus the disadvantages of increased taxation "differ" from country-to-country "and we should not expect them to be the same here as they might be in Britain or America" (Lynch, et al., 1945, pp. 447-449).

Unemployment was not the real issue, he argued – unlike Lynch – because the unemployment figures really "consist largely of unemployables…. rather than unemployed". And besides, flattening the industrial business cycle was not imperative, he argued, because it was upon "the prosperity of agriculture", not industry, "that our level of employment… depends". This he argued was contingent in Ireland's case on "vicissitudes in the export prices for our agricultural produce and changes in… the 'foreign balance'", and not the industrial business cycle, and so "we have not to contemplate the same degree of State control as they will… in the interests of full employment" (Lynch, et al., 1945, pp. 447-449).

Full employment does not *necessarily* apply anyway, he argues, echoing his later famed thesis on "productive employment" in his 1956 paper, because "unless you can create jobs here that are as productive as those abroad, you can only increase the level of employment by forcing people to take up lower-paid employment here". However, full employment is "quite possible to achieve", he admits, "if we are not too squeamish about interfering with personal rights" but "I believe most people would rather see it achieved by some means which will pay due attention to" these rights (Lynch, et al., 1945, pp. 447-449). Whitaker's concerns about encroaching upon civil liberties echoed his future Minister for Finance Sean MacEntee's sharply suspicious

views of Beveridge's social and economic proposals in Britain, views echoed widely in Ireland at the time (Feeney, 2009).

Certainly, it appears that industrial fluctuations were not a pressing issue for Ireland given its mainly agricultural economy. Nevertheless, his response could hardly be described as being steeped in Keynesian considerations, being as it is concentrated almost exclusively on the primacy of private sector investment. One can also see here in early embryonic form his later conception of the importance of productive employment. In contrast, Lynch himself clearly and explicitly states his belief in the need for state intervention, while Whitaker expresses misgivings.

The 1952 Balance of Payments Crisis

In early 1952 Ireland would experience what was considered an existential-level crisis arising from a balance of trade deficit-driven external sterling assets drain. Due to its excess of imports over exports arising from a stagnant industrial export sector, Ireland was depleting its external sterling asset reserves to cover imports throughout the post-war period from 1947 onwards, resulting in a balance of payments deficit of £35 million in 1950 and a deficit of £38.8 million in the second quarter of 1951 (Fanning, 1978; Kennedy & Dowling, 1975).

Both Joe Lee (1989) and Kennedy and Dowling (1975) persuasively argue that the balance of payments had stabilised by itself by the time of the 1952 budget and speculate that the Department, led by the conservative J.J. McElligott, saw the crisis as an opportunity to reassert fiscal orthodoxy. Even as early as the end of the decade however it was widely recognised that the 1952 balance of payments issues arose from temporary world conditions – especially global stockpiling in reaction to the onset of the Korean War, a phenomenon that stabilised naturally (Lynch, 1955).

The Department of Finance however considered this to be a crisis-level drain resulting (at least ostensibly) from excessive import-driven consumption that, if not curbed now would see the balance of payments deficit accelerate (Murphy, 2009). In their view the situation was not going to rebalance on its own. Inflation, both from wage increases and due to the character and scale of the public capital programme were blamed by Finance for Ireland's balance of payments deficit (Fanning, 1978).

Whitaker's diagnosis of the situation mirrored the Department's. As he predicted in 1949, he ascribed the increased balance of payments drain to excessive disposable income, conferred by massive state spending, leading to increased consumer goods imports. He advised that both current and capital expenditure be curtailed and a larger proportion be funded by taxation – thus moving it out of the "capital budget" heading whose introduction Lynch had precipitated not two years earlier (Feeney, 2009).

The possibility that external, short-term factors like global stockpiling in response to the Korean War as opposed to state-induced inflation through capital investment may have caused the import surplus spike was apparently not considered, much less investigated (Kennedy & Dowling, 1975; Ó Gráda & O'Rourke, 2021). According to the Department's own figures, of an increase in imports of £36.1 million from the 1952 total, only £10.6 million – 29.3 percent of the total – was an increase in the volume of imports, while the remaining £25.5 million – 70 percent resulted from increased prices, a factor not influenced by capital spending-induced inflation (Feeney, 2009, p. 180).

After initial internal initiatives to curtail imports through tougher exchange control scrutiny of import applications as a first step, Minister for Finance Seán MacEntee's April 1952 budget – the earliest in history – would attempt to "choke off" import demand at source by

reducing food subsidies such as tea, butter and sugar and by raising duties on “luxury” items such as tobacco, alcohol and petrol, as well as increasing income tax (Fanning, 1978).

To put this into broader content, the key issue during the period, as Patrick Lynch would later outline, was that there were really only two options to reduce balance of payments strain: Either increase export-oriented production, or reduce the volume of imports through export controls and targeted consumption tariffs as well as cuts to state spending, leading to a choking-off of economic activity (Lynch, 1957).

Facing public opposition, the budgetary response shied away from slashing the capital budget as the Department had advised, reducing the cut in spending overall. However, Whitaker made clear in his 1983 book *Interests* that the concept of using a Keynesian stimulus through public spending to increase export production was not considered when he notes the Department’s (and, he makes clear, his own) “unease… about the automatic equation of ‘capital service’ and ‘proper to be met from borrowing’” and laments Minister for Finance MacEntee’s failure to remove the heading of “…voted ‘capital services’” in the 1952 budget altogether, which would have abolished the capital budget principle introduced in 1950, which in turn would have reduced public spending still further at the same time as the 1952 austerity budget (Whitaker, 1983, pp. 86-87). He was therefore not at that point concerned with Keynesian pump-priming during a downturn but was in fact – even forty years later – annoyed that it had not been cut further.

UCD economist (and later parliamentary secretary to the Second Inter-Party government) John O’Donovan at the time expressed a similar view to Joe Lee’s that signs were appearing that the 1952 figures were stabilising. He wrote in the *Evening Herald* in July 1953 that “…the returns of the commercial banks…will show that they do not confirm… [the] depletion of our sterling assets”, that imports were falling by themselves; and expressing the

view that the import-export deficit would self-correct on its own (Evening Herald, 1953). Cormac Ó Gráda (1997) endorses O'Donovan's assessment.

O'Donovan also observed that when "…to the action taken in the budget… there was added rates of interest… completely out of line with rates in other countries… the jerk to the economy was altogether too severe…". He argues that this "led to a huge increase in unemployment which is the most serious problem facing the Irish economy to-day" (Evening Herald, 1953).

This appears to be a contrasting argument to the Department's. For O'Donovan, the effects of curtailing credit and the consequent unemployment effects (which never seemed to rank highly in Finance's considerations) were the core issues, relating to demand and the functioning of the economy. It also represents in contemporary (rather than retrospective) perspective an awareness both of the damage the deflationary budget would do and the lack of necessity for those measures.

Chapter 4 - Dark Night of The Soul: 1952-58

The 1955 Interest Rate Decision

In January and February 1955 the UK bank interest rate was raised to reduce inflationary pressure by deflating consumer-goods demand (Honohan & Ó Gráda, 1998). In Ireland the decision was taken by government for the first time not to follow suit, with a view to preventing an increase to the cost of capital for economic activity (Honohan & Ó Gráda, 1998). The 1952 Fianna Fáil government had considered lowering interest rates, but was dissuaded by the Governor of the Central Bank, Joseph Brennan (Honohan & Ó Gráda, 1998).

The move was advocated for by then-parliamentary secretary to the government John O'Donovan, later an economist at UCD, in a government memorandum. He argued that Ireland's financial position was stable, and so was the domestic banks' profitability, and that

as such Ireland's economic position would not be compromised by maintaining a lower interest rate than the UK (Honohan & Ó Gráda, 1998). In light of this, he argued that maintaining the interest rate would stimulate economic growth.

T.K. Whitaker's position is unclear. In a document from March discussing the interest rate decision and desirable banking reforms, he makes scant reference to the decision. Instead he recommends banking reforms focused on convincing the banks to deposit their London-based asset reserves (totalling over £60 million) with the Central Bank to increase the Bank's capacity to rediscount Government securities, and provide further exchequer bill discounting (Department of Finance, 1955, p. 30). His direct feelings on the interest rate decision are not made explicit as a result, but he did consider the balance of payments "satisfactory", suggesting that at that point he did not believe the interest rate decision would cause a sterling assets drain (Department of Finance, 1955, p. 31).

Nevertheless, his playing-down in *Economic Development* of the utility of interest rates as a tool to stimulate economic growth is likely indicative of his views on the issue. In it he wrote that "the maintenance… of… sterling as an international medium of payment… is of greater significance…than the adverse effect [of British interest rate rises] on productive development" and that "…Interest is…. not of great consequence in production costs… and… have not prevented Germany, for instance, from achieving a vast expansion in production" (Department of Finance, 1958, pp. 25-26).

Whitaker frequently expressed affinity for the low inflation, tight monetary policy-driven social market philosophy of post-war Germany, which was distinct from the Anglo-Saxon Keynesian approach pursued by the US and UK and inspired the general low-debt approach to fiscal-economic policy of today's Eurozone fiscal rules (Brownlow, 2010). Interestingly, Whitaker's concern to increase the sustainable liquid buoyancy of the banks

seemingly was not a concern shared by O'Donovan when he advocated for the interest rate freeze at the outset, who argued that their liquid reserves were already ample (Honohan & Ó Gráda, 1998).

As far as can be ascertained, neither Louden Ryan nor Patrick Lynch in their writings during this time focus on the bank-driven lending market; writing in 1954 Ryan advocates the establishment of a National Investment Board, through which current savings specifically could be reallocated to industries in need of loan liquidity (Ryan, 1954), while Lynch focuses more on current savings than interest rate initiatives (Lynch, 1955).

It seems unlikely either man would be especially keen on reducing interest rates and with it the effect it would have in diminishing the returns-incentive to save more. Their savings focus does not appear to be the most Keynesian-inspired approach, motivated as it is by the fear of the *damage* stimulating demand would cause by increasing imports of consumer goods rather than concerns about Keynesian demand-management, and mildly evoking the "paradox of thrift" (Federal Reserve Bank of St. Louis, 2012).

Whitaker's "Damascene Conversion"

The conventional wisdom as represented by Fanning (2009) and Chambers (2014) depicts Whitaker's 1956 paper before the Statistical and Social Inquiry Society of Ireland, 'Capital Formation, Saving and Economic Progress' as a departure from his past positions – especially the classical positions explicitly espoused in his 1954 paper 'The Finance Attitude' (1954). However, the ideas Whitaker outlined up to this point in relation to Marshall aid, the capital programme and the 1952 crisis – especially around the importance of savings over capital injection and the deleterious impact of state investment on the balance of payments – represented the core of his 1956 argument, rather than a departure from previous views.

In this paper he directly rejects Lynch's 1949 diagnosis of the malaise affecting the Irish economy as being due to *underinvestment*, which in Lynch's 1949 opinion could be rectified by state capital (Lynch, 1998). "It would be a mistake", Whitaker warned, "to think that a faster rate of increase in output is a matter merely of stepping up the volume of home investment ("domestic capital formation") [brackets in original]" in the vein Lynch had advocated for in 1949, thus directly refuting the effectiveness of Keynesian demand-management (Whitaker, 1956, p. 6). He also rejected external asset repatriation as a viable source of development funding, writing that "if domestic capital formation is accompanied by an equivalent reduction in external capital there is no net addition to national capital", thus necessitating the need for a "balanced" balance of payments account (Whitaker, 1956, p. 6).

Instead, he contends that it is "saving", not state investment, that "is the means by which resources are made available for capital development" (Whitaker, 1956, p. 56). Ireland's fundamental problem was instead that "the proportion of gross national product devoted to capital formation in Ireland is low", asserting that economic growth "can itself be realised only if the income saved is used for productive investment in the sense of building up capital assets which will enlarge the flow of income in the future" (Whitaker, 1983, pp. 28-29).

Ultimately, for Whitaker it was a choice between "consumption or saving" without regard for any intrinsic need for some form of (what was then an inherently Keynesian but is today a mainstreamed) conception of the need for economic demand to sustain activity in the economy, in large part neglected in his schema because of the propensity (as in the view of most Irish policy-makers of the time) for demand to lead to increased consumer goods imports to satiate it (Federal Reserve Bank of St. Louis, 2012).

He places the bulk of the blame for the proportion of GNP devoted to capital formation being low on the public capital programme, writing that "the present pattern of our domestic

capital activity is shaped by the state capital programme", which "contains a large proportion of [social] works which do not yield an adequate direct return", therefore not increasing economic development (Whitaker, 1956, p. 12). As a result, the "state-financed capital programme is so large a proportion of total capital formation… that… all the available personal savings are needed to support the Public Capital Programme".

This is akin to a "crowding-out" argument, which posits that government spending displaces private spending at a near parallel ratio, which, in the words of Carlson and Spencer (Carlson & Spencer, 1975, p. 2) is "one of the issues which helps to distinguish between followers of the two major macroeconomic schools of thought – Keynesians and monetarists". As a result of this crowding-out effect as perceived by Whitaker, by this stage, "… current savings are not sufficient even to support the present relatively low rate of capital formation" which between "1949-54…[required] drawing on external capital… with a corresponding reduction in net savings and in net *national* capital formation", without a tangible return via "productive investment" (Whitaker, 1983, p. 40; 46).

In other words, in Whitaker's view the state investment programme was draining unseemly proportions of otherwise-private capital which then consequently could not be used by the private sector. External asset repatriation, as he notes, was a deduction from capital formation in his schema, not an addition. This was fundamentally the same forewarning he made when the public capital programme was first being considered in 1949, that it would exceed savings and necessitate external asset repatriation (Whitaker, 1956).

Modern economic analyses have not referred to the bleakness of the 1950s as being caused by a "savings and capital formation deficiency crisis". Economists Kieran Kennedy and Brendan Dowling for example noted the fixation on the part of the policy-makers of the time

with diagnosing Ireland's economic underdevelopment as being due to undersaving. They criticise this assessment, writing that,

> …the Banking Commission argued that external assets should not be used to fund domestic investment unless it had a net export effect equal to the net inflow. With an apparent lack of such investment opportunities, the low current saving ratio was treated [by the Central Bank and the Department of Finance] as an absolute shortage of capital [which prompted the] fiscal retrenchment after the sizeable… balance of payments [deficits] in 1951 and 1955. These views gave little recognition to the likelihood that, had the resources been used to secure greater economic development, personal and company saving would have responded favourably.
>
> (Kennedy, et al., 1988, p. 35)

Interestingly, Fanning (1978, p. 502) sees Whitaker's 1954 article in *Administration*, 'The Finance Attitude' (1954) as starkly contrasting with what he sees as the more Keynesian views Whitaker would go on to espouse in 'Capital Formation, Saving and Economic Progress' (1956). He points to Whitaker's emphasis in his 1954 paper on "the difference between the closed economy in which Keynesian principles could most safely be expected to work and an open economy exposed to world conditions and balance of payments vicissitudes", as well as his contention that "savings forced from the community… by high taxation yielding budget surpluses… [are] not net savings but… [are] offset by dissaving in other ways and by inadequate provisions for private capital replacements and extensions" (Whitaker, 1954, p. 8). In other words, the only place Keynesianism works in the real world, according to Whitaker's perspective in 1954, is the blackboard.

Fanning contrasts his 1954 views with those expressed in 'Savings, Capital Formation and Economic Progress'. However, in this 1956 paper Whitaker made a virtually identical assertion, writing that,

> Saving enforced by taxation yielding a budget surplus is a recognised means of curbing inflation but if it is too severe it may… [lead] to dissaving…and… inadequate provision for private capital replacements and extensions. A deliberate policy of inflation…. Another way of securing forced savings, would require a virtually closed economy to be fully effective… The "multiplier" might work

in a country completely closed to the outside world in which at the start there were idle resources… In the real world, however, there are few… completely isolated economies and the effects of the creation of new incomes are, therefore, not wholly retained within the system… [leading to] loss of external resources or reduction of the exchange value of the currency—as to… negative the initial boost given by the increase in home investment.

(Whitaker, 1956, pp. 196-197)

These are essentially identical statements, and would be reiterated in his diagnosis of the 1956 balance of payments crisis. A Keynesian perspective would likely categorise mass unemployment of labour as an "idle resource", but Whitaker's various analyses tend not to focus on employment, let alone the concept of "full employment" made popular by Beveridge and others (Feeney, 2009).

Though Whitaker's position on the public capital programme became more pragmatically accepting by the late 1950s, his economic worldview could perhaps best be described as that of a "sound money" economist – as he approvingly quotes Friedman – a more monetarist than Keynesian emphasis that focused on the integrity of the currency and the "weighting" of credit to productive output to ensure monetary stability – and with it Ireland's peg with sterling – as a priority (Whitaker, 1983).

That Whitaker in his 1954 paper explicitly endorses the explicitly "classical" – rather than Keynesian – view behind "Gladstone's dictum that 'the more you leave in the taxpayer's pocket, the more prosperity there will be'", which he considers to be "a proper *a priori* position for a Department of Finance" reinforces this impression (Whitaker, 1954, p. 45). Even as early as that 1954 paper he was writing that "public expenditure… [is] resources withdrawn from private use, resources which would presumably be equally… [or] even better employed if left in private hands" (Whitaker, 1954, p. 45). This, in non-technical, embryonic form is the crux of the argument he made in 'Capital Formation, Saving and Economic Progress' – the choice in use of finite resources drawn from finite current savings between public and private ends.

Patrick Lynch, Charles Carter and Louden Ryan, the three external economists who would participate in the Capital Investment Advisory Committee, by this point did not disagree with the core tenets of Whitaker's 1956 article. One year earlier Lynch, now a UCD economist, had written an article entitled 'The Irish Economic Prospect' (1955). His view had seemingly changed from diagnosing Ireland's core problem as being one of general underinvestment to a belief that economic expansion was dependent on "savings from current income" rather than basing fiscal policy on external asset-funded state investment alone, for "If Ireland is… to increase exports, to escape from… stagnation… there must be more productive investment of a gradually growing volume of current savings" (Lynch, 1955, p. 9).

Echoing Whitaker's complaints about the public capital programme draining domestic savings, Lynch draws attention to the various Central Bank reports' warnings about "'over-investment'", which is where "…the state induces foreign disinvestment [in terms of external asset repatriation] when domestic investment is in excess of current savings" (Lynch, 1955, pp. 14-15). This is in spite of being precisely what he had advocated in 1949 in calling for a "*repatriation of sterling through a deliberately contrived deficit in the balance of payments* [emphasis added]" (Lynch, 1955, p. 15).

Further, the risk of excessive consumption leading to severe balance of payments difficulties is averred to when he quotes the Central Bank's long-held "warnings against imprudent 'encroachments' on the foreign investments… [which] yield… [dividend] income" (Lynch, 1955, pp. 8-15). This makes clear that Whitaker and Lynch's philosophies differed initially, especially in view of Lynch's advocating state investment in the late-1940s while Whitaker initially opposed it. Only later did both men's views start to align in common, coalescing around commonly-held views which manifested themselves in 'Capital Formation, Savings and Economic Progress' (Whitaker, 1956).

Writing in 1954, Trinity College economist Louden Ryan expressed similar views, emphasising the necessity of productive investment and the dangers of borrowing (Ryan, 1954). In 1957 Charles Carter of Queens University would concur, expressing similar scepticism about the efficacy of non-productive public spending as a means towards economic growth and reiterating the need for increased savings – sentiments Lynch would endorse in his comments (Carter, 1957).

It thus becomes clear from this that external assets policy and balance of payments crises were therefore widely-held concerns. Amongst the policy actors studied there is little indication of differing policy positions to those assumed by the Department of Finance during the 1952 and 1956 crises, apart from John O'Donovan's contributions. Therefore, although quantitative accounts retrospectively highlight the two crises as policy errors born of conservatism, there is much alignment in perception between the Finance mandarins and the state's most prominent "radical Keynesian" economists (Kennedy & Dowling, 1975; Ó Gráda, 1997; Ó Gráda & O'Rourke, 2021; Irish Times, 2021).

Each individual – again seemingly bar John O'Donovan – harboured similar concerns that rather than spurring economic growth, rising demand would simply lead to larger import deficits and thereby larger, more frequent balance of payments crises, which thereby ruled out the Keynesian "pump-priming" multiplier as a tool of economic growth. These views would again come to the fore during the 1956 balance of payments crisis.

The 1956 Balance of Payments Crisis

In 1956 Ireland experienced another balance of payments crisis. A balance of payments deficit that first substantially emerged in 1952-54 grew sharply in 1955 to £42m. (Honohan & Ó Gráda, 1998; Lee, 1989). Honohan and Ó Gráda (1998) argue that the government-sponsored 1955 interest rate decision precipitated the crisis. In essence, the lower interest rates led to

increased borrowing by non-bank businesses, who took advantage of the reduced costs of borrowing to pay off UK debts with Irish loans (on a much larger scale than the proportion of the balance of payments deficit caused by greater imports – which the Department and Central Bank blamed for the crisis). The problem was cumulatively caused by a drain of Ireland's external assets of £50 million in 1956 composed of a combination of excess imports (£17 million), outward capital flows (£22 million) and a decline in exports (£10 million) (Honohan & Ó Gráda, 1998, p. 5).

The Central Bank and Department of Finance each held similar views. In a memorandum dated January 19, 1956 for the Minister for Finance on the situation, the Bank diagnosed a "deep-rooted excess of demand in relation to supply… since 1947" that was fuelled by increased disposable incomes from government expenditure which led to balance of payments issues as imports grew to meet consumer goods demand (Central Bank of Ireland, 1956, pp. 9-23).

In parallel, it argued that the dwindling of state-owned external assets and the consequent dependence on the commercial banking system to pay for capital investment resulted in "an almost complete monopoly of the capital market by the public authorities" – again the same argument as made in 'Capital Formation, Saving and Economic Progress' (Whitaker, 1956) in terms of a crowding-out effect – while asserting that "A sustained rise in our incomes and employment… depends… not upon increased availability of domestic credit but upon…[increasing] our export earnings" – the same criterion for permitting state investment set out in *Economic Development*, which itself was identical to that set out as far back as 1949 (Department of Finance, 1949). With this in mind it recommended that the country "should in future pay for its investment [exclusively] out of current income and savings" and that investment that did not increase "economic production" be cut (Central Bank of Ireland, 1956, pp. 9-23).

Writing in two memorandums in 1957, a year after the worst of the crisis had subsided, Whitaker concurred with the Central Bank's thesis, expressing his preference for a "balanced" balance of trade budget. He favourably notes that "near equilibrium was achieved" in the balance of payments from 1952-1954 "but over-spending in 1955 caused a deficit of £35 million". The "Special measures taken in 1956 to curtail imports" reduced "the deficit to £14 million" (Department of Finance, 1957, p. 8). However, "to protect the economy from any undue loss of external resources, particularly from their wasteful use merely to support consumption in excess of current production" it was important to "maintain the present balance which has been achieved" and "bring external payments into line at a higher level (Department of Finance, 1957, p. 8). He would recite this word-for-word in *Economic Development*, as he had in his 1956 paper (Department of Finance, 1958, p. 16).

The crisis would recur if an expansionary fiscal policy was pursued, he warned. As in 'Savings, Capital Formation and Economic Progress', he dismissed a Keynesian export growth multiplier, warning that "Higher expenditures on public works would cause capital to be diverted from the private sector… [and] Imports would tend to rise, without a corresponding increase in exports", opening a gap in "our external payments, to be bridged by further liquidation of sterling", thus ruling out a Keynesian multiplier intended to increase exports and reduce the deficit (Department of Finance, 1957, p. 6).

Instead it would cause "the commercial banks, just emerging from past difficulties" to be "subjected to undue strains on their liquidity" to cover the sterling drain via their reserves, thereby restricting the "supply of credit for *productive* purposes [emphasis added]" (Department of Finance, 1957, p. 6). In short, as Whitaker had diagnosed in 1949, and as the Department and Central Bank had during the 1952 crisis as well, public spending – along with wage increases – was to blame (Department of Finance, 1957, p. 6).

Whitaker makes this non-Keynesian warning unmistakable in *Economic Development*, writing that “setting idle resources to work would, in our circumstances, [only] lead… to increased imports” which would cause balance of payments deficits, financeable only “by drawing on external capital or incurring external debt” (Department of Finance, 1958, p. 32). This reasoning, about the non-applicability of Keynesianism “in our circumstances” rings throughout his writings.

In another unsigned but hand-edited document in Whitaker’s files marked March 1957, Whitaker writes that the intention must be to “make a switch in spending, from consumption to investment” (Department of An Taoiseach, 1957, p. 21). which is quite revealing – unlike in the traditional Keynesian schema, consumption (i.e., demand) to Whitaker (or McElligott) does *not* lead to investment – investment is a very particular, closed-circuit process for Whitaker that completely bypasses the process of consumer *demand* leading to increased sales and thereby profits that can then be reinvested by businesses to fuel economic expansion (Library of Economics and Liberty, 1999).

Because in Whitaker’s schema “only current savings… add to national capital” and as such, “disinvestment” through sterling repatriation “must be subtracted from… net domestic capital formation in order to arrive at the true rate of… national capital” and are a deduction, not an addition to national economic product, it seems that in Whitaker’s view a balance of payments deficit would have been untenable irrespective of the level of external reserves available (Department of Finance, 1958, p. 16).

The memo further diagnoses the stagnancy of economic activity as being a product of “the level of private, as distinct from public, investment in Ireland… [being] unduly low, and has been clearly insufficient to sustain economic activity at a reasonable level”, again another restatement of his doubt about the efficacy of state-led demand-management due to his

perception of its “crowding-out” effect on private sector activity (Department of Finance, 1957, p. 10).

In sum, contrary to the conventional wisdom, Whitaker’s economic ideas, especially those espoused in his 1956 paper, did not represent a radical departure – as has been suggested – from traditional Finance orthodoxy. The ideas espoused in his 1956 paper – on the damage done to savings and thereby national capital formation on the one hand and the balance of payments on the other by capital spending, and on the need therefore to reduce consumption to encourage savings were therefore not radical departures from the traditional Department of Finance philosophy that informed the response to the two balance of payments crises; these ideas were in fact what informed the deflationary response in both instances.

Ultimately, the advice of the state’s financial mandarins was heeded. Minister for Finance Gerard Sweetman introduced several rounds of budgetary measures in an attempt to stem the outflow of sterling. Special import levies and additional taxes were levied in March, followed by a widening of these levies and increases to their rates in the May budget, followed a few months later by additional levy increases and a £5 million cut in expenditure (Ó Gráda, 1997).

The 1956 budget speech reflected the core focus of the Department and Whitaker perspective’s as he laid out not only in his Statistical and Social Inquiry Society paper that month but also in his 1949 memorandum: State spending was exceeding current domestic savings and external reserves were being exhausted in unproductive capital investment which led to import inflation (Fanning, 1978).

The budgetary approach taken ultimately stabilised the balance of payments, but at a pronounced cost to domestic economic activity; a reduction in industrial and agricultural output

of three percent and seven percent respectively. The policy trade-off of stabilising the balance of payments was a 1.3 percent fall in GNP (Murphy, 2009).

No connection was apparently made between the level of unemployment or the consequent reduction in economic activity and the deflationary budgets of the previous year. It seems that no general cost-benefit analysis of the cost tradeoff inherent in stabilising the balance of payments through deflationary budgeting at the cost of stifling domestic economic activity was ever done – whatever about the necessity of the budgetary deflation – either in 1952 or 1956.

For his part, Patrick Lynch supported the 1956 budget. Writing in 1957, he notes that Marshall aid helped cover the balance of payments deficit, but noted it to be a debt on future productivity which would have to be repaid through increased taxation. He notes that from 1952-1954,

> … [the] deficits in the balance of payments were of comparatively insignificant magnitudes, but in 1955 the deficit rose to over £35 million. The various restrictive measures which the Minister for Finance imposed last year were intended to correct the tendencies which had left such a large sterling gap in our balance of payments in 1955; if they had not been arrested, these tendencies might have produced a further serious loss of sterling in 1956.
>
> (Lynch, 1957, p. 14)

He therefore echoes Whitaker's view that the crisis was precipitated by an increase in imported consumer products, and supported the measures taken by Gerard Sweetman.

Unlike in 1949, Lynch now believed that "however necessary" investment in housing and social infrastructure "may have been on social grounds, [it] gave no immediate impetus to the productive ability of the economy", thereby echoing Whitaker's focus on economically *productive* investment as distinct from social (and thereby *unproductive)* investments (Lynch, 1957, p. 21). Louden Ryan adopted the same view, positing that the problem was a result of a

drop in exports and a rise in imports, which he attributed to increased consumer spending. He too supported the budgetary measures, noting it would be necessary until export production was raised (Ryan, 1956).

John O'Donovan, the parliamentary secretary to the government on the other hand disputed that there was a balance of payments deficit of sufficient seriousness to warrant budgetary deflation; he argued that "on every occasion that we… put our industrial output on a higher level, we must in the opening stages draw on the external assets of the commercial banks," but that thereafter "we do not draw more, because the transactions are subsequently self-financing" (O'Donovan, 1956, p. 1).

This is reminiscent of a Keynesian multiplier argument in a way that the other arguments are not, not only in its defence of the validity of a stimulus effect but also in its support for, rather than criticism of, capital spending. Despite presenting an alternative – arguably more Keynesian – diagnosis, O'Donovan was an outlier, however, and his ideas were less coherent and well-presented than those of the other economists in their delivery.

Conclusion

The decade between 1948 and 1958 was an important period in Irish economic and political history. Economically eventful, it saw two major economic crises that collectively suppressed economic activity for most of the decade (Ó Gráda, 1997). Paradoxically, it also saw the growth of a more expansionary state, with the momentous decisions to avail of Marshall Plan funding (which the Department of Finance opposed) and to repatriate external assets, which funded a public investment programme investing in social infrastructure such as public housing and hospitals, an eerie echo forward in time to the housing crisis of today.

The economic thought underlying the decision-making of the first half of this period is much less focused upon in the existing literature than the events of the second half of the

decade, and little work has been done to understand the genesis and ideological hues behind the initiatives mentioned above compared with those of the late-1950s, like the *Economic Development* study (Department of Finance, 1958). This study is seen as a watershed moment, described by many commentators as the point when the country's financial policy became unashamedly Keynesian, so-described in part due to the Programme's planning characteristics (O'Mahony, 2021).

There is also little existing research on the influence of Keynesian versus classical economic thought in national economic policy-making during this period; The conventional narrative posits that working together the state's premier civil servant, T.K. Whitaker, and the country's leading younger generation of economists, Patrick Lynch, Louden Ryan and Charles Carter (of Queens University Belfast) shifted the economic policy of the state into a Keynesian orbit, spearheaded by Whitaker's *Economic Development* study.

The foundational threads of this narrative do not study the individual stances of each person or consider other alternative economic voices. Moreover, they do not consider how their stances may have differed during each individual event of the time, resulting in a gap in the existing literature as to influences upon each man's economic philosophy.

This study addresses this niche in the existing literature by examining a series of the major economic event points and crises of this ten-year period prior to the publication of *Economic Development* in 1958 in order to attempt to determine the position of each of these four individuals plus John O'Donovan, UCD economist and parliamentary secretary to the Second Interparty Government, as well as those of the Central Bank and Department of Finance through primary source archival material wherever possible.

Using this approach the study makes five key findings. Firstly, it finds that Whitaker's philosophy was not especially Keynesian-inspired. Its main tenets – its emphasis on the need

to encourage domestic savings in preference to demand-side stimulation, his constant exhortations to lower taxation to increase “incentives” for enterprise in the private sector, as well as his negative conception of demand as being little more than “consumption” which, rather than being viewed, as a Keynesian would, as a core element of economic activity it is instead seen by Whitaker to merely precipitate balance of payments instability.

Moreover, contrary to the contemporary portrayal, as represented for example by Fanning (2009) and Chambers (2014), of Whitaker’s ideas as a breakaway from the traditional Central Bank/Department of Finance view, The aforementioned core concepts underpinning Whitaker’s economic philosophy can be traced back to the institutional ideas frequently recited by these institutions in the late 1940s, ideas which in themselves when discussed in the context of their use by these institutions are considered to hail from a classical rather than Keynesian economic perspective.

Again in contrast to the conventional wisdom, this study has also found that Patrick Lynch’s economic ideas and policy advice initially differed from Whitaker’s. At the beginning of this period Lynch advocated the *utility* of external asset-driven state investment for expanding economic activity. However, by the mid-1950s Lynch’s published contributions shifted, now focusing on the overriding importance of the same economic variables as Whitaker – saving, maintaining balance of payments equilibrium, and the *damage* state investment was doing by causing inflation and draining savings. The same goes for Charles Carter and Louden Ryan.

By 1956, the year of the second major balance of payments crisis, four out of the five economists studied held the same perspective on the key issues; each considered the balance of payments the overriding concern and did not offer an alternative policy approach or situational perspective, either relative to each other or to the two ostensibly “conservative”

financial institutions. The only exception to this was John O'Donovan. This largely precluded the emergence of a more expansionary (or merely less severe) fiscal approach prior to the Lemass era.

Finally, with this in mind *Economic Development* (Department of Finance, 1958) must be viewed as a less-than-favourable response to existing self-described Keynesian-inspired developments like the public capital programme (Whitaker makes this explicit in his semi-veiled references to renouncing previous policy commitments and preconceptions in *Economic Development*). This becomes all the more evident when, as has been shown, four out of the five most influential economists and the two state financial institutions all blamed state capital spending – an undisputed Keynesian-inspired initiative – for the balance of payments crisis due to capital investment-induced inflation. This was thus the overriding priority of the late 1950s.

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