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GOVERNMENT AND THE COLONIAL ECONOMIES: A REPLY TO FROST

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Frost's comments on my article highlight ongoing issues that surround railway construction in the Australian colonies between 1860 and 1890. His comments do, however, misrepresent key arguments I made and attribute to me arguments I have not made. He also appears to misunderstand why it was that so much of the construction undertaken in the 1880s was misconceived. I deal first with questions of misrepresentation and wrong attribution.

The main target of Frost's criticism is my claim that decisions to build railways in the colonies took on classic 'public choice' characteristics, thus occasioning much wasteful expenditure during the later years of the boom.[1] Frost goes on to say, 'Here Boot is expanding an old argument; indeed, the view that public investment was authorized for non-economic reasons – to buy votes – has been part of conventional wisdom for so long that most writers have accepted it uncritically.'[2] Frost's description of what he claims to be my view is exaggerated by taking features I describe as appearing in the 1880s and attributing them to the whole period. These features are then parodied into gross forms. The overall effect is to represent my view as one in which colonial parliaments were mere arenas where cynical, rent-seeking politicians selected lines for construction simply on the basis of the votes they would buy and the opportunities they created for maximizing the personal wealth of individual politicians. This does not represent my view nor, as far as I can judge, does it represent that of N. G. Butlin on whom I drew for my information.

1 My view is encapsulated in the following quotation from my article: 'At first governments approached the task of railway building cautiously and with fairly strict attention to profitability. Gradually, however, decisions to expand the system came to take on classic public choice features. A concern for profitability soon gave way to less quantifiable, though politically easily justified social and general economic considerations. By the mid-1880s, when even these vague criteria had been abandoned to permit extension of railway networks for political ends, prospective economic returns became largely irrelevant to expenditure decisions.' Boot, Government, p. 91. Frost does not deny this statement is an accurate summary of the essential elements of Butlin's account of the processes involved in the selection and construction of colonial railways up to 1890. Butlin, *Investment*, pp. 352–69.

2 Frost, Alternative view, see p. 73 above.

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Does Frost characterize the public choice perspective of human behaviour correctly? According to Buchanan, that perspective assumes persons in public life act no differently from other persons the economist studies.[3] The difference is that public choices are made in an environment where there are no exact parallels to the restraints on private behaviour arising from the opposing motivational pulls of narrowly defined and short-term self-interest, on the one hand, and enlightened long-term self-interest on the other. The resulting decisions are thus more likely to be ill-judged than if they were taken privately, though not because those who made them had bad intentions, as Frost wants to believe. One reason public choice theorists give to explain this outcome is that public choices are made collectively, making it difficult to identify responsibility for bad decisions retrospectively. Another is that the bridges linking decisions to spend with the responsibilities of financing the expenditure are often ignored or not recognized in public decision-making by those who do the spending. The financial implications of public spending are, as a consequence, usually less carefully considered than they would be if the spending was undertaken privately. And this is how things turned out in the colonies. Initially, colonial governments do appear to have contained their enthusiasm for public spending accordingly, but there seems to be little doubt they found it increasingly hard to do so during the later stages of the railway building boom. Unfortunately, Frost has mistakenly chosen to take this reasonable view of events to mean that I believe the colonial politicians involved in public expenditure decision-making were unscrupulous vote-seekers bent on maximizing personal rather than community benefits.[4]

Of lesser importance, Frost alleges that, in spite of contradictory evidence, I continue to argue that public investment crowded out private-sector activity.[5] He also criticizes me for arguing that labour shortages were generally more severe in rural areas than in the towns, and that assisted migration did little to limit wage costs or the growth of government demand for labour.[6] I made none of those arguments. Even the most cursory reading of pages 92–5 of my article will show that I was critical of Butlin's arguments on all these points. My conclusions were:

1 Butlin's central contention that public-sector competition for capital and labour crowded out private activity remains controversial.[7]
2 His argument that government-inflated capital and wage costs distorted the whole structure of the economy is equally controversial and has been thrown into question by the work of Lougheed and Tomaschki.[8]

3 This paragraph draws on Buchanan, *Public finance*, ch. 7, and Buchanan, *Liberty*, chs 3 and 9.
4 For one explanation of the origin of this misunderstanding see Buchanan, *Liberty*, p. 25.
5 Frost, Alternative view, see p. 81 above.
6 Frost, Alternative view, ibid.
7 Boot, Government, p. 92.
8 Boot, Government, p. 94.

3 In the absence of more detailed work by historians, it is difficult to judge the effects of assisted migration programs either on the numbers arriving in Australia, or on the level of wages and employment.[9]

4 That labour shortages were severe in districts close to where railway construction was taking place, and that manufacturing was less affected by labour shortages partly because of the growth of female and child labour in cities.[10] I made no comment that could be taken to infer that labour shortages were generally more severe in the countryside than in the cities.

An important part of Frost's article is his account of the processes used to select railway lines for construction. Colonial governments, he argues, were aware of the dangers of indiscriminate spending and that in Victoria governments adopted market-based criteria to prioritize the lines that should be constructed. The Victorian Lands Department provided data on the number of farmers and the estimated value of land to be served by each proposed line, and the Railways Department provided estimates of construction costs. Together, he says, these data provided a rough-and-ready means of judging the marginal rate of return against the cost of borrowing. 'Having determined how much money could be prudently raised for railway construction on the London market, governments in Victoria used their list of priorities to decide which lines would be constructed, stopping when their available funds were fully accounted for.'[11]

There are several problems with this argument. Estimates based on future trends in settlement, land values, and expected growth in trade – especially for lines designed to tap the Murray and Darling River districts – were based on flimsy evidence about what might happen once a line had been built. The estimates were also made without considering whether the New South Wales and South Australian governments might construct competing lines with the same aim. Well-intentioned planners endowed with optimism about the colony's future could make of these estimates what they wanted, especially if funds had already been raised or were relatively easy to come by in London. Whether market-based criteria were used to select lines was, however, less important a problem than whether the lines were capable of contributing

9 On the question of the effects of assisted immigration Frost quotes me as follows, 'For Boot, assisted immigration "did little to ease the pressures on wage costs . . . because the number of assisted migrants tended to lag behind, and sometimes well behind, the growth of government demand for labour". Frost, Alternative view, see pp. 81–2 above. Quoted in full, the sentences from which Frost extracts his quotation read: 'According to Butlin, assisted migration did little to ease the pressure on wage costs even during peak years of arrivals in 1877 and 1883. This is because the number of assisted migrants tended to lag behind, and sometimes well behind, the growth of government demand for labour.' The words attributed to me are clearly my paraphrasing of Butlin's view.

10 Boot, Government, pp. 94–5.

11 Frost, Alternative view, see p. 77 above.

enough revenue to cover their running costs, without interfering with the cost of servicing and retiring the debt incurred to pay for the system as a whole. The overwhelming evidence is that as enthusiasm for building increased in the late 1870s and 1880s, planners ceased asking this question. Consequently, increasing numbers of lines were selected for construction in Victoria and in the other colonies that were incapable of meeting the debts incurred by building them, given any realistic expectation about the future of colonial development. Frost provides no evidence to controvert this view.

It is well known that railways have difficulty capturing enough of the benefits they create in the form of revenue to make it worthwhile, in most cases, for private individuals to consider their construction, at least without government help. This is the main reason why governments took over responsibility for railway construction in the colonies. It is also a reason why economic historians have been so keen to estimate the total benefits accruing to railways in the form of social savings. These social savings represent important benefits arising from the existence of railways. Nevertheless, where lines are selected for construction because of their ability to generate savings, it is still important to know whether those savings can be converted into enough revenue (taxable or otherwise) to cover the running costs and related debts associated with constructing the line. This fact was especially important in the colonies where lines were increasingly justified in terms of their alleged social benefits. Unfortunately, the prospect of converting enough of the benefits alleged to be attached to lines built in the 1880s to revenue for the purpose of running the lines and servicing debt was remote. Thus, while some benefits translated into freight and passenger revenue, a large proportion of any that remained emerged either as one-off capital gains to producers in the regions serviced, or as lower prices to final consumers of Australian agricultural goods, many of whom were overseas. Nevertheless, debts incurred in building the lines still had to be paid. Moreover, they had to be paid in the currency of the lending country. The outcome, once the flow of foreign capital stopped in 1891, was that domestic consumption and net imports had to fall by enough to make up the debt payments. The fact that governments had also invested heavily in urban improvements only compounded the problem since, by their nature, such improvements rarely added to the stream of income available for servicing the debts they represented.

This analysis does not, of course, imply that the outlays made by colonial governments were wasteful in any sense, or that they were the products of wicked men. The debt-financed spending spree that took place in the 1870s and 1880s may well have provided a railway system and public urban amenities considered at the time to be more valuable than the debt instruments required to finance their construction. The problem was that the lines and buildings were quite incapable of servicing the debts they represented. Even the durability of a line or building was insufficient for it to be labelled a net asset with a present net value unless it produced an increment to net income capable of being used to pay the debt created to pay for it. After 1891 this fact came to haunt the Australian colonies. Effectively, most of the railway spending in the 1880s (and the public part of urban construction) was equivalent to someone who had gone on a consumer-spending spree, only to wake up in 1891 with little to show for it but a huge debt. Although the colonies owned an extensive rail system and many fine buildings, income was no higher and there was a debt that needed to be paid. Consumption had to be reduced accordingly, and the colonies found themselves the poorer. Unfortunately for Australian citizens, debt-financing problems lasted for many years after 1890 providing lessons that, if the experience of the 1920s is any guide, their governments refused to learn.

Frost suggests that I rejected B. R. Davidson's estimate of the social savings of railways in NSW giving insufficient reasons to explain my rejection. I readily admit to giving insufficient reasons but not to the rejection of Davidson's estimates. My criticism of Davidson's estimates was designed to point historians to those parts of the estimates where I believed deficiencies were most likely to be found. The most important of these appeared to me to lie in the road and rail haulage rates he used to estimate the savings. These appeared to contain biases that were likely to inflate considerably the resulting estimate of savings made. For example, the road haulage rates used to calculate the cost savings on the transport of wheat and general merchandise, which together account for more than 50 per cent of the estimated savings for the period 1860–1913, are at least 50 to 70 per cent higher than rates reported by the Department of Roads as operating in 1864.[12] This is in spite of the likelihood that competition from rail would have caused road rates to fall between then and the end of the century. Conversely, the railway rates are between 6 and 28 per cent below those reported in the Annual Reports of the Railway Commissioners in the 1890s.[13] Taken together, these will yield a rate differential that could only magnify the apparent savings gained by transporting goods by rail rather than by road. Railway rates also contained many thinly disguised subsidies designed to encourage shippers to move their goods by rail rather than by road. In the hypothetical world of social savings the danger of ignoring the presence of subsidies is that they artificially increase the quantities carried by rail and reduce those carried by road. When the resulting quantities are multiplied by artificially inflated road/rail rate differentials, they further magnify the estimated savings from using rail rather than road.

Two final points should be borne in mind. The first is that Davidson did historians a service by seeking to redress the lack of attention to the positive

12 Davidson, Benefit cost analysis, table 2, p. 133, and p. 148.

13 *Annual Reports of the Railway Commissioners of New South Wales*, 1892–3, pp. 7–8, 1894–5, pp. 6–7, *Annual Report of the Chief Commissioner of Railways in New South Wales*, 1903, pp. 6–7.

benefits of the railway achievement. Until more work has been done to check the validity of his estimates, however, their size and the fact that little has been done to check their accuracy should warn historians to treat them cautiously. The point of my comments was to stress the need for caution and for careful checking of Davidson's estimates, not to reject them. The second point I want to emphasize is that, whatever their size, unless those savings could be turned into a revenue stream capable of servicing the debt, they did not represent a net gain to those who bore the burden of debt. The fact that opportunities to capture the savings for this purpose were remote meant the resources used to build them were wasted so far as Australia's debt position was concerned. As a consequence of ignoring this fact there arose a debt crisis and depression which, with all the associated balance of payments problems, unemployment, asset destruction, loss of income, and reduced consumption, was more severe because of the choices governments had made between 1870 and 1890. Had those governments been less generous with their spending their economies would have been better fitted than they were to enter Federation and the twentieth century.

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