SOME ASPECTS OF THE ECONOMIC HISTORY OF THE INTERWAR PERIOD (1918-1939)

By

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I

When the German armistice was signed on November ll, 1918, World War I was over. But it was over only in so far as the armed hostilities had ceased. Beyond these, it left a trail of consequences with which the world had bitterly to contend in the subsequent years.

It is not easy to minimize the material losses that the war had inflicted in the form of direct destruction of physical resources, particularly the appalling loss of life of over 33 million casualties,[1] and in the form of indirect destruction through the hindering of maintenance and progress, by diverting effort to the unproductive applications of the war.

And yet, comparatively speaking, this was the less significant part of the dammage done by the war—a part which the world could get over in a considerably shorter time. The other part, the more significant, continued to haunt the economies of the world, if not unassisted, for two decades, until another war came to the rescue. This was the legacy of the war in the form of dislocations and maladjustments.

The situation after the war was very aptly described in a famous quotation of M. Theunis, President of thc World Economic Conference held at Geneva in 1927. "The eight years of postwar experience," he said, "have demonstrated the outstanding fact that, except in the actual fields of conflict, the dislocation caused by the war was immensely more serious than the actual destruction."

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1. See F. W. Hirst, *The Consequences of the War to Great Britain*, 1934, p. 295.

The maladjustment was both internal and external. On the internal side, the war had resulted in a reshuffling of economic resources to meet the war needs, which had somehow to be readjusted after the war to the requirements of a peace-time economy. War finance contributed a considerable accumulation of national debts which greatly increased the difficulties of the governments in balancing their budgets. The extent of the accumulation of national debts is shown by the fact that forty leading nations came out of the war period with their national debts totaling 190 billion dollars above their 1914 level.[1]

On the international side, the dislocation was even worse. During the war, former channels of international trade had been obliterated, while new suppliers appeared to take advantage of the broken connections. Some of these were national infant industries which were subsequently to clamour for protection. Some were new foreign sources of supply that had after the war was over to contend with the original sources of supply, national or foreign. Major nations emerged from the war only to find themselves confronted with a severe alteration in their international economic position. The United Stated emerged as a creditor nation which refused to accept the requirements of its new position. England, dependent upon imports, could not easily adjust the structure of her economy to meet the consequences of her reduced overseas investments. Germany, under the pressure of her obligations, had to change from an import-surplus country to an export-surplus one. New nationalities were soon to appear with little regard to their economic vitality. The legacy of international debts and of reparations that the war left over was soon to be a disruptive influence amidst the efforts towards adjustment.

The world, therefore, had a truely vast problem to deal with. In dealing with it, it was only natural to expect each of the interests concerned to be alertly on its guard to shift the bruden of the necessary adjustment whenever possible. When governments gave in, as in many cases they did, to the pressures of the different interests, an additional source of maladjustment appeared, although the object was not infrequently the slowing down of the adjustment rather than its avoidance.

1. J. P. Day, *An Introduction to World Economic History Since the Great War*, 1939, p. 26.

Nor was the attitude of mind with which the world attacked its postwar problems immune from the war. The great catastrophe had shocked people's faith in the world and its existing institutions, and led to a strong predisposition for discarding hitherto accepted standards in favor of a strong urge for experimentation. This, together with the pressure of events, greatly colored the efforts of the postwar period. And to the extent that experimentation was laden with errors and blunder, the problems of maladjustmmnt acquired additional force and confusion and further dragged the world into the abyss of dislocation.

II

The immediate problem that faced the nations just emerging from the war was the problem of rehabilitation and reconversion. Generally speaking, after the first world war there were no elaborate plans for ensuring a smooth transition from war to peace.

In England, the government was aware of the seriousness of the problem, and attempted to make arrangements with other countries, with public bodies and with important industries to place large orders that can serve as a substitute for the vanishing government demand. To counteract the still disturbing possibilities of dislocation from the the sudden throwing on the labor market of the large numbers demobilised, the government, in addition, secured legistative measures to maintain the level of wages in the period immediately following the war, an to provide for an "out-of-work donation". The result of these measures, says Professor Pigou, was that "at no time throughout the period covered by the transfer did the number of persons involuntarily out-of-work...rise appreciably above the million mark".[1]

In the United States, planning for postwar rehabilitation was even more markedly absent. Orders for the cessation of war production included little relief for the 9 million persons engaged in the war industries, and the entire armed force of 4 million men was demobilised within one year from armistice day. In neither case was there any adequate official plan for re-placement; the job of re-placement was primarily left to the efforts of voluntary bodies. It is estimated that post-armistice unemployment stood in February 1919 at 3 million.[2]

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1. A. C. Pigou, *Aspects of British Economic History, 1918-1935*, 1947, pp. 1-34.
2. G. Soule, *Prosperity Decade*, 1947, Ch. 4.

Nevertheless, however great the hardships of postwar adjustment to the peace-time economy, they soon became absorbed in the activities of the postwar boom. In England, employment increased about 3% during the postwar boom from April 1919 to April 1920 In spite of this, however, production in England during the boom was still about 10% less than production in 1913. Pigou explains this by the still large amount of unemployment that persisted during the first part of the boom, together with the postwar reduction in the working day and the deterioration of equipment during the war. The export market too was still hampered by prohibitions and restrictions.

The boom is usually characterised as a boom in working capital which arose from business confidence in the prospects for the future. The basis of this optimism clearly lay in the "immense amount of work" that was needed for postwar reconstruction. But several other factors were also important. First of these was probably the removal of wartime controls. During the war these controls had been gradually tightened from a stage of intervention through collective agreements, to one of compulsory price-fixing, to still another of requisition and direct allocation. The main arguments in favor of retaining control in certain fields were the necessity for the protection of key industries or its desirability to promote operational efficiency, such as had been the case with railroads during the war. But trade interests were against the maintenance of controls, and the government agreed to their point of view. Thus, shortly after the end of the war, wartime controls were removed.

The second important factor in encouraging business optimism was the extention of private credit. The reluctance of the country to impose hardship on its internal activity for the sake of protecting its gold reserves, by raising the discount rate, led to the formal abandonment of the gold standard in March 1919. This gave the Bank of England wide freedom in its internal credit policy, a freedom which was used for promoting and accentuating the scale of the boom. Thus, between April 1919 and April 1920, the British price index rose by 56%.

In the United States, a similar boom was experienced. The nature of this boom seems to have been similar to that of England, that is, speculative accumulation of inventories was its main source. This speculation was also financed by the expansion of bank credit using government bonds as collateral. The role played by government bonds, coupled with the need of the treasury for funds after the war, hampered effective credit restriction. And it was this force that ultimately led the boom to expand to unwholesome dimensions. But in the meantime other forces equally or less important were also at work. The most important of these was the continuation after the war of the high level of exports particularly bolstered by the immediate postwar need for relief in Europe and by private lending abroad for financing foreign purchases for reconstruction. Other factors of a semi-passive character included the continuation of government spending on a high level well into 1919, and the absence of great technical difficulties in the conversion of plant and equipment to civilian production. However, a factor that seemed to be acquiring increasing importance was the demand for automobiles. The rest of consumers' demand did not play a large role since consumers were deprived of very little during the war. The result of these forces was a slight rise in the gross national product, but accompanied with a rise of 33% in prices during the period of the boom.[1]

III

The boom came to an end by the beginning of 1920. The crash seems to have started in Japan, where some ascribe it to the action of the Bank of Japan by which it raised its discount rate for the purpose of curbing inflation.[2] Although one may be skeptical about the validity of a such purely monetary explanation, the interesting thing is that the rest of the world soon started to experience a similar deflation. In England, wholesale prices dropped from a high of 225% above the prewar level in may 1920 to a low of 55% above she prewar level in 1922. And at the bottom of the slump, April-June 1921, unemployment was around 22-23%. This very high level of unemployment however is to be accounted for in part by the coal strike of that year. Pigou considers the slump, taken as a whole, as predominantly a home-market decline. "It was probably mainly associated with the cessation in the process of building up additional working capital".[3] This cessation undoubtedly has to be explained by the changed attitude of business. The major factor in influencing this attitude appears to have been the termination of the work of reconstruction. When the various tasks of rehabilitation and reconstruction "have been carried so far as it was found practicable to carry them", says Pigou, "there was nothing obvious to

1. See G. Soule, *op. cit.*, Ch. 4.
2. See J. P. Day, *op. cit.* p. 45
3. A. C. Pigou, *op. cit.*, p. 73

take their place".[1] This, however, was only the major force at work. The high bank rate seems in addition to have had some effect, although this effect was largely psychological rather than an actual impact on the supply of money. The maintenance of the high rate of 7% for nearly a year after the decline had started was certainly an aggravating factor in the slump. It was, however, part of the conscious deflationary policy of the country which aimed at facilitating the return to the gold standard. Over and above all this, the slump fed upon itself in several ways. Wages continued to rise for some six months after the downturn in prices. Financial difficulties beset those who had bought capital during the boom at the inflated prices. And as the slump spread and became more serious, foreigners started to cancel their orders in England. Amidst this general decline, however, one item escaped the fall and instead even increased. This was the index of real wages which rose to about 11% above the prewar level. Pigou explains this phenomenon by the fact that the effects of the war were primarily dislocations rather than actual destruction of capital equipment which means that the requisites for a high level of productivity were not lacking. There is room to suspect, however, that the increased power of trade unions had a great deal of influence in this repect.[2]

The collapse of the boom in the United States was also severe. Wholesale prices fell from a level of 227 % in 1920 to a low of 150% in 1921. Industrial production declined from 40.1 billion dollars to 37.6 billion. And unemployment in 1921 was estimated at 4.75 million. The primary factor in this decline was the reduction in the demand for exports, especially of farm products. This was the beginning of a severe plight for agriculture. The story began with the great expansion of agricultural production consequent on the huge war demands. This demand was, however, only temporary. And when Europe resumed its normal agricultural activity after the war, surplus production was bound to appear. This is what happened. Although the existence of surplus production was temporarily hidden by the speculative activity in agricultural commodities, the real situation soon became clear and agricultural prices dropped sharply. An additional source of the reduced demand was the decline in government expenditure. The government suddenly started to spend less than it received, thus burdening the

1. *Op. cit.*, p. 188.

2. Pigou, *op. cit.*, pp. 208-211, and cf. Hirst, *op. cit.*, Ch. 3.

economy with the duty of absorbing, within little more than a year, a decline in government demands of about one quarter of the total national income. Building activity was hesitant, partly because mortgage loans were almost unobtainable, and partly because, being a long-term investment, the prospects of the continuation of high levels of rent were not bright. The traditional role of speculation was also there, private credit being to a large extent employed for speculative purposes, a fact which may be taken as an excuse for the Federal Reserve policy of restricting credit. The Federal Reserve Board noticed that short term credits were renewed instead of being paid off as they are supposed to be. They therefore warned member banks against renewal and raised the discount rate. By itself, however, such policy would not have been sufficient to cause the collapse. Other theories of the postwar collapse, such as the theory which attributes it to a buyers' strike against high prices, or the theory that it was the result of the deliberate policy of the banking interests which profit from deflation because of their creditor position, do not seem to have found wide acceptance.

During the postwar depression, a basic change in British foreign trade policy occurred through the enactment of the Safeguarding of Industries Act in 1921. The object of the act was to provide protection for certain key products. This was to be ensured by a 33 % tariff for the protection of these products. The same tariff was also imposed for protection against exchange dumping, that is, against the importation from countries with depreciated exchanges; and against price dumping, that is, against commodities sold below their cost of production in the country of manufacture. Automobile importation also come under the tariff, but only as a luxury. With the passage of the Safeguarding of Industries Act, England abandoned her traditional policy of free trade. On the monetary side, on the contrary, the policy of the country was to revert to orthodoxy, through the avowed intention to reestablish the gold standard and at the old parity. Apart from considerations of international prestige and honesty, it looks as though the attempt of the British to obtain a high sterling return on their overseas investments played a large part in this policy. At any rate, a necessary preliminary to reestablishing the gold standard was the restoration of the prewar relationship between the British and the other national levels of prices. In particular, it was necessary to reduce the level of British prices relative to that of American prices. The best that could happen was a reduction in British prices while American prices rose at the same time. When, however, American prices too fell because of the depression, the burden of adjusting British prices was certain to prove unbearable. One advantage, nevertheless, was reaped from the depression fall in American prices and this was that they fell relatively less than the British prices, with the consequence of substantial improvement in the sterling exchange.

In the United States, the major problem arising from the depression was the plight of the farmer. In fact, the farmers were the group that was the hardest hit by the depression. This was especially true of those among them who had bought during the boom, or borrowed to buy. The other economic groups were relativey better off. Although there was neither unemployment insurance nor organised government relief, those in the labor group who remained employed enjoyed higher real earnings. The business group was of course the least hit, particularly big business, which did not seem to have been affected by the depression and continued to pay out dividends and interest all during the depression out of the huge surplus that they had accumulated during the war.

While the depression was running its course, two important attempts at international collaboration took place in the form of the Brussels Conference of October 1920, and the Geneva Conference of 1922. The first conference aimed at stabilisation in the monetary field and the ultimate restoration of the gold standard. It also undertook several specific reforms for the resumption of international trade. Some writers attribute to the recommendations of the conference an important role in causing the postwar depression, on the basis that its recommendation of stabilisation broke the bullish market.[1] The second conference in 1922 mainly repeated the recommendations of the first, with this difference that it advocated a gold exchange standard instead of a pure gold standard. "A participating country," said resolution 11 (3), "in addition to any gold reserves held at home, may maintain in any other participating country reserves of approved assets in the form of bank balances, bills, short term securities, or other suitable liquid resources." To establish such a standard, the participating countries should balance their budgets, fix gold parities, establish free exchange markets, and encourage cooperation among the central banks. This cooperation among central banks was to be arranged by a meeting which never eventuated. And therefore international control over the value of gold remained absent.[2] With regard to commercial policy,

1. See J. P. Day, *op. cit.*, pp. 42 ff.

2. See League of Nations, *International Currency Experience*, Ch. 2.

the conference again condemned obstacles to free international trade, such as tariff changes for the purposes of economic warfare, import and export prohibitions, instability of legal and administrative measures, and it recommended freeing raw materials from duties (except fiscal duties) and the adoption of the most-favored nation clause. All these measures were hence aimed at the liberation of international trade.[1]

One particular country was in the meantime experiencing its own particular development, which was to acquire importance as time went on. This country was Russia. By 1921, Russia had gotten over her period of war communism and embarked on the New Economic Policy. Land had been seized by the peasants after the first revolution, and soviets were established in the factories, with the result that production fell drastically. After the second revolution, extreme centralisation of control to meet the dangers of counterrevolution, of war and of insurrection, coupled with the militarisation of industrial workers and the requisition of agricultural products, resulted in serious discontent. War communism also saw no need for money, and the rouble was left to depreciate rapidly as the best way for its destruction. These unsatisfactory conditions, however, were gradually giving place to more progressive conditions. The New Economic Policy with its restoration of money, and the temporary concessions to private trading, ushered in the period of planned development.

IV

With the end of depression, economic progress was resumed in the world. In England, recovery from the postwar depression did not come until the beginning of 1923. When it came, however, it was only partial recovery. "The monetary slump was over, but employment was still, according to prewar standards, extremely bad." (Pigou) During the subsequent period of recovery, unemployment was never below 9%. Pigou explains this situation by referring to the failure to accomplish the necessary adjustment to the changed conditions. During the war, there had been strong shifts in demand conditions. A number of foreign countries had started to produce for themselves. Substantial decrease in British foreign investments put new burdens on the export industries. And agricultural production was increased by the large acreage and the technical improvements in the New World and became a source of strenuous competition to European production. The hardest hit by

1. League of Nations, *Commercial Policy in the Interwar Period*, ch. 2.

such developments were the "unsheltered trades" — those exposed to foreign competition — and particularly the export trades. The adjustment between sheltered and unsheltered trades and between both and foreign conditions should have been accomplished by adjusting relative wages. Such adjustment, however, was not vigorously forthcoming. Instead, it was slow and hesitating. Several reasons have been offered as an explanation. One reason was that the adjustments that were needed were much too large to be effected by the direction of new recruits, which is the common way of adjustment under normal circumstances. As to large shifts of workers among the different industries, the difficulties were great, for on the one hand, the hope that demand will revive reduced the incentive to such movements, and on the other hand, even if such incentive was present, it was hard for the workers to decide where to go. An illustration of such difficulties was afforded by the fact that movement in the overcrowded engineering industries was nevertheless continuing. The lack of flexibility in the wage rates of the sheltered industries was a factor tending to aggravate the maladjustment.[1] It must be noted here that the flexibility in the wage rates which was desirable was flexibility with regard to long run changes in the economic conditions of England. The plausibility of such an explanation of the incompleteness of the recovery in England depends on the fact that Pigou limits his analysis to the period ending in 1925. In that year, England went back on the gold standard at the old parity. The resulting overvaluation of the pound imposed upon the country's economy the impossible task, not only of adjusting the relationship between the sheltered and the unsheltered industries, but also of adjusting both to the falling level of world prices. Illustration of the hardships involved in such a task was vividly furnished by the industrial unrest of 1926.[2]

In the United States, the end of the depression marked the beginning of a "New Era" of economic prosperity that was almost uninterrupted except for two minor recessions. As soon as the inventory losses that had been suffered during the postwar collapse had been absorbed, the economy was again on its feet. In 19:4, signs of overproduction started to appear together with the symptoms of correction in the form of inventory reductions. But the recession was slight and

1. See Pigou. *op. cit.*, pp. 40-55.

2. See J. N. Jones, *Britain in Depression*, a volume edited by the British Association, pp. 3-21,

was moderated by the coordinated efforts of the newly created Open Market Committee. In 1925, the economy was advancing again, with the market for durable goods acquiring a steadily increasing importance. Durable goods production, including buildings, automobiles and others, was in fact the most active element in the subsequent expansion. This expansion was accompanied by immense gains in productivity. The index of man-hours per unit of output in manufactutring fell from 74 in 1919 to 42 in 1929. This gain was not limited to the industrial sphere, for agriculture made similar though less spectacular gains, the same index falling from 84 in 1919 to 67 in 1929. Apart from this, however, agriculture did not share in the general prosperity. Wage earners were certainly better off with a gain in per capita real earnings of about 15%. The greatest beneficiaries of the increase in productivity were, however, corporation owners, whose growing profits were not only used in distributing larger dividends, but were also used for accumulating vast surpluses which altered the methods of business finance, and played an important role in the speculative mania that preceded the stockmarket crash in 1929. Signs of the underlying strain beneath the outward appearance of soundness were evident in the recession of 1927. In that year, consumers' spending fell off because of the limited purchasing power of wage earners and farmers. Most conspicuous was the fall in the purchase durables. Automobile purchases declined. So did residential construction and the purchase of producers' durable goods. In spite of all this, however, the boom kept on expanding. The crucial factor here was that, while the business recession was occuring, the stock market kept on rising. A major factor in making possible such a marked discrepancy between the behavior of the stockmarket and that of commodity markets was the general belief in a new era of prosperity which had been attained, and since the commodity price indices did not fluctuate, that the economy was not in danger. This was not only a popular belief, for even well informed observers came to the conclusion that the public must have been right when they saw the persistent stability of commodity prices. Because of previous experience, when the collapse of the Florida real estate boom failed to inflict serious effects on the economy, people also believed that legitimate business must be somehow isolated from speculative activity. If we add to this the effect of easy money on the general optimism, the case becomes clear why the stock market continued to rise and even carried with it the whole economy. Easy money was not only the result of the policy of the Federal Reserve System, which sought to moderate the recession of 1927 and to cooperate with England to enable her to maintain the gold standard, but was also the result of the vast surplus funds of business that came to the stock market to seek the returm which could not be obtained in the business field. And to the extent that these funds dominated the market, checking the speculative boom was outside the hands of the Federal authorities. In this manner the collapse of the new era that seems to have been due in 1927 was postponed until the stock market crash in 1929.

Aside from the cyclical aspects in England and the United States. the period from 1923 to 1929 was pregnant with international occurrences of great importance. Away from the focus of international events, Japan started in 1923 to have a story of disaster that prevented her from concentrating her attention on solving her imminent population problem, and this contributed to the subsequent Japanese aggression. The catastrophe of the earthquake of 1923 not only inflicted its direct effects, but was indirectly the cause of the Japanese panic of 1927 because of the unsound loans that the Bank of Japan felt obliged to give in order to bridge the country over its losses.

More important than this, however, from the point of view of the immediate future, was the reparations tangle between Germany and the allied powers. The London Ultimatum and Schedule of payments of May 1921 fixed the amount of reparations at 33 billion dollars and Germany was required to make annual payments of 275 million for the period 1921—1925 and of 900 million thereafter. Under the pretext of a slight default, French and Belgian troops occupied the Ruhr in January 1923 as a means of coercing Germany into making full payment. The German government, however, objected to the occupation and decided to follow a policy of passive resistence. Workmen who refused to work under the French occupation were given a liberal dole; merchants whose goods were confiscated by the French were given liberal compensation; and so forth. The thing which is important here is the way in which the passive resistence was financed. It was financed almost solely by the discounting of Treasury bills with the Reichsbank.[1] This policy was the proximate cause of the spectacular inflation of the mark that was to follow. Of course, it was not the sole cause. Immediately after the war, Germany was confronted with a series of serious elements of instability in the form of an unbalanced

1. See S. Flink, *The German Reichsbank and Economic Germany*, 1930.

budget, large reparations payments, and the need for the importation of large amounts of foodstuffs. But her conditions immediately after the war were not much worse than those in the other major nations involved in the war. The incident that gave vent to these elements of instability was the occupation of the Ruhr. This occupation proved to be costly to both Germany and France and still it was ineffective. This state of affairs finally convinced the French government to withdraw her troops. But not until a great deal of maladjustment had ensued. On November 20, 1923, the American dollar was selling on the Berlin exchange at the rate of 4.2 trillion mark for the dollar. In addition, the British coal industry enjoyed a temporary unsound prosperity that was to be followed by great distress. The German economy does not seem, on balance, to have suffered greatly from the inflation. Its largest loss was on current transactions in merchandise because of the unfavorable rate of exchange. And this was even more than compensated by the large gains which Germany made on the sale of its money abroad since inflation amounted actually to a repudiation. The only serious effects seem to have been the redistributive effects which almost wiped out the entire German middle class.[1] With the inflation of the mark out of the way, however, Germany soon became the first country to reestablish the gold standard. The stabilisation of the mark was the work of Dr. Schacht.[2] On november 12, 1923, he was given wide powers to undertake the job which others had refused to risk undertaking. The experiment of the Rentenmark, queer as it was, proved to be highly successful and gave an clear illustration of the importance of confidence in economic events. The final step was taken when the Act of August 1924, providing for the reorganisation of the Reischsbank, put Germany on a gold exchange standard with a minimum reserve requirement of both gold and foreign exchange of 40% provided that the percentage of gold reserve does not fall below 30%. The main source of inflation, the discount of Treasury bills, was finally obliterated by the explicit admission in the act of the independence of the bank from the government. A maximum to the amount of Treasury bills that could be discounted at the bank was fixed at 400 million marks. And the bank in fact refused to lend the government any more when this limit was reached. Only on two occasions was there any threat to the stability of the currency until the

1. See F. D. Graham, *Exchange, Prices and Production in Hyperinflation Germany*, 1930.

2. See K. Bopp, *Hjalmar Schacht, Central Banker*, 1939.

Great Depression. The first was the threatening inflation of 1924, which resulted from an overextension of agricultural credit. But it was quickly suppressed by a policy of strict rationing of credit. The second occasion was the stock exchange speculation of 1927 which was also successfully suppressed by restricting credit for speculative purposes. The industrial picture of Germany during the period was dominated by the post-inflation rationalisation movement and the liquidation of many unwieldy concerns and combines which had been formed under the impetus of the inflation.[1]

The wave of currency stabilisation that started with the German stabilisation continued during the greater part of the remaining twenties. We have seen that the German stabilisation was actually a repudiation of the old currency and the creation of a new one. Other countries stabilised their existing currencies, only at a reduced value, including Belgium, France and Italy. On April 23, 1925, however, England was back on the gold standard at the old parity and the Bank of England was allowed to sell gold at that price in bars of about 400 ounces for the purpose of export. The stabilisation movement was concluded with the French restoration of the gold standard under Poincaré in 1928 at about one fifth of its prewar parity.

The restored gold standard, however, had to contend with severe strains which were ultimately to succeed in bringing about its downfall. We have already referred to the reparations tangle and the difficulties that faced Germany in making the annual payments, entailing the disasterous occupation of the Ruhr. The United States of course had no direct relation with the reparation problem since she demanded no payments from Germany. In August 1922, however, England notified her war-debtors that she would collect from them only enough to pay her debts to the United States. With this manoeuvre, the debts of the United States became tied up with the receipt of reparations from Germany. And the United States had to recognise that, although interallied debts and reparations had no legal connection, yet from a practical point of view, they were actually connected. Therefore, when the Dawes plan scaled down the reparations payments of Germany, the United States also scaled down the interallied debts by percentages which ranged from 29.8 for Finland to 80.2 for Italy. In spite of these arrangements, the payment of both reparations and interallied debts encountered severe

1. See J.A. Schumpeter, *Business Cycles*, vol. II, ch. 14.

difficulty. The difficulty arose from the very nature of international transfers. An international transfer can be effected in one of three ways : By the transfer of gold, by the transfer of goods through an export surplus, or finally by the transfer of certificates of indebtedness through international borrowing. This was equally true both for Germany and for the allied powers. As to payment by the transfer of gold the magnitude of the settlements made the existing stock of gold insufficient to carry out continuous payments. The second means of making internaional transfers by acquiring the necessary exchange through an export surplus, was severely crippled by the policy of the creditor countries. The reason for this was the fear of foreign goods, particularly because of their impact upon the employment conditions in the creditor country. We have already referred to the abandonment by England of her traditional free trade policy by the Safeguarding of Industries Act of 1921. Protective inclinations were also manifest in the United States by the Fordney - McCumber Act of 1922. Some prefer to call this a failure on the part of the United States to adjust to her new creditor position, the argument being that, because the realisation of an export surplus in the prewar period was necessary for the payment of interest and dividends to the creditors of the United States, it came to be considered a requirement for national economic health, a belief which was so deeply entrenched that it could not be swiftly changed under the impact of the new conditions.[1] The argument seems to be overdrawn because the tendency towards protection is a general feature of the postwar world. At any rate the second route for carrying out international transfers was virtually blocked. There remained therefore only the settlement through international borrowing. And this was the route actually utilised. The United Stated lent to Germany both by the flotation of German securities in the United States and by the direct investment in Germany. In addition tc this, the United Stated lent to Germany on short term an amount estimated at 1. 3 billion dollars in 1929, which proved later to be a severe element of instability. The dollars that Germany received as loans from the United States were used in part to pay her reparation installments to the allies, who in turn used the proceeds to pay their debts to the United States. The money thus flowed baek to whence it had come originally and the net effect was that in so far as payments were made the indebtedness of Germany was substituted for that of the allies. In spite of this delusion, at least

1. Soule, *op. cit.*, p. 252 ff.

outwardly, obligations were being fulfilled and the international system was safe. The real character of the situation, however, uncovered itself as soon as American lending began to fall off in the middle of 1928. This was not at the time the only strain on the international mechanism for the Great Depression was on the threshold, and when it came American imports also fell off, reducing still further the availability of dollars abroad. When this happened, no hope could be entertained of the possibility of effecting the required transfers, for the last road for doing this was now decidedly blocked.

As if the maladjustments of international debts were not enough strain on the newly restored gold standard, England in 1925 realised her determination to return to gold at the old parity. The result of the consequent overvaluation of the pound was the drain of gold from England to France and to the United States. Amidst the general devotion of the time to the gold standard, the United States had to choose between cooperating with England to enable her to remain on gold and giving priority to the needs of internal stability by curbing the threartening stock market speculation. The confiict between the two lines of policy was reflected in the rivalry between the advocation of a low discount rate by the Federal Reserve Bank of New York and the advocation of raising the discount rate by the Federal Reserve Bank of Chicago.[1] Unfortunately New York won; and the Federal Reserve Board adopted a policy of cooperation with England. This was unfortunate because the stock market crash of 1929 finally brought about the downfall of the gold standard that policy tried to avert, and the world was only left with a more severe collapse than it had to suffer.

In spite of these dark spots, the latter part of the twenties was marked by such strides in economic progress that Schumpeter has christened the period as the "industrial revolution of the twenties".[2] Of course the greatest strides were made in the United States. But England too partook of the general pattern, and "the role of the outstanding leaders — electricity, chemistry and motorcars — is obvious." (Schumpeter). The dominating feature of the twenties, beside the rise of the new industries, was the appearance of the movement for rationalisation. In fact, the idea of rationalisation dominated the international eco-

1. See Soule, *op. cit.*, p. 272.

2. See *Business Cycles*, vol. II, ch. 14; also his article in *American Economic Review*, Supplement, 1946.

nomic conference that was held in Geneva in 1927. The conference advocated the striving for maximun labor efficiency, the reduction in in variety, i. e. standardisation, the avoidance of waste in industry, and the simplification of the stage of distribution. Beside its concern with the problem of rationalisation, the conference also emphasised the importance of free trade, and once again condemned prohibitions and quantitative restrictions and advocated the reduction of tariff barriers by individual, bilateral or collective actions. The international convention which was the result of the work of the confernce, however, was never ratified, and the prosperous twenties failed in achieving the restoration of free international trade.[1]

V

The close of the twenties, however, was destined to be immeasurably more dramatic, for in October 1929, the United States experienced the most formidable stock market crash that ever occured in peacetime. Speculation in the stock market had been a consistent feature of the "new era". Under the influence of the general optimism of the time, participation in speculative activity was wide and the sense of risk was dulled. By late 1929, the composite index of the prices of a hundred leading stocks had soared from a low of 72 in 1924 to a high of 208.8. The market value of the shares listed on the New York Stock Exchange jumped from 27 billion dollars in 1925 to 67 billion in 1929. A large part of the rise was due to the increase in the number of shares listed rather than in the average price per share. A flood of new issues was forthcoming. Existing corporations issued new shares, not because they were in need of additional capital, but because a gain could be made out of their manufacture. Investment trusts appeared for the formal purpose of ensuring the diversification of holdings that the individual investor could not achieve, but in many cases were simply a device for financial promotion. Pools and syndicates were formed to profit from the rising market and in may cases did not refrain from using improper manipulations for furthering their interests. Huge empires, like those in railroads and in public utilities, were formed for the purpose of concentrating control. All these formed a prolific source of new issues which the public snatched off the market with no more than a most superficial acquaintance with the underlying

1. League of Nations, *Commercial Policy in the Interwar Period*, ch. 3.

conditions of the issuing company. The advice of their salesmen and investment houses was frequently either equally incompetent or not disinterested. The result of all this was that the stock market prosperity had no sound basis in the general activity of the economy as a whole. When decline started and the reality of the situation began to be realised, the unprecedented crash was actually inevitable. The scramble for the liquidation of holdings flooded the market with a torrent of sales which reached 12.8 million shares on "black Thursday", October 23. In one day, October 22, the total value of the stocks listed on the New York Stock Exchange declined by 4 billion dollars. By the time the crash had run its course, not only the weak speculative securities had suffered, but prime securities of well-established, reputable corporations were also badly hit. Of course the direct sufferers were those who were unfortunate enough to be "left holding the bag", whoever they were. But the effects were soon to spread to the rest of the economy through the impact of capital losses on the spending of those who were caught.

The first half of 1930 was not a period of serious decline in the United States. Business declined only slowly. But in the second half of that year the contraction became more serious and "distress signals" appeared. The Bank of the United States failed in December. Wholesale prices fell, especially those of raw materials which were in December 20 % below January. Total money income by the end of the year was 15.1 % below 1929. "But the most serious features of the picture (were) displayed by the indices of industrial production and of employment," the former declining by over 22 % while the latter declined by over 16% over the year.[1] The decline continued with minor interruptions especially in the beginning of 1931 and in the middle of 1932, until the index of business activity (of the New York Times) hit the lowest point in the middle of March 1933, at 63 % of the estimated normal.[2] Unemployment had been proceeding at the annual rate of 4 million since 1929 until it reached the annual average of about 12.6 million in 1933.

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1. See Schumpeter, *op. cit.*, pp. 911—917.

2. See Broadus Mitchell, *Depression Decade*, pp. 32—33 ; also Schumpeter, *op. cit.*, p. 924 ff.

The picture is very similar in England, although the timing may be different. For although all indices of employmet and output hit the low point in the fall of 1932, the indices of wholesale prices reach their low at the beginning of 1933. At any rate, unemployment reached its highest annual average in 1933, at 22.1 %. In the same year, the Board of Trade index of industrial production hit the lowest level of about 77% of the 1929 prodution level. Compared with the fate of industrial production in the United States, the relative mildness of the depression in England is an outstanding feature.

VI

The attitude towards the depression in the United States was at first one of optimism. Then, gradually, as the extent of the catastrophe became obvious, attempts to lay the blame on foreign sources appeared. Little, however, had been done on a sufficiently adequate level to alleviate the distress or to encourage revival. The philosophy of the Hoover administration was one of laisser-faire, and economic revival was therefore in the main left to the initiative of private business. Of the few attempts made in the direction of active policy, one of the earliest was the Agricultural Marketing Act of 1929, which appropriated half a billion dollars for the purpose of making loans to cooperative associations to permit them to give larger advances to their members than could be secured otherwise. The result, as may be guessed, must have been an "invitation to uncontrolled production". Nevertheless, this was at least one of the few points that could be counted in favor of the administration. Not so with the next important measure, the Hawley-Smoot tariff of 1930. This act which jumped the rate of import duties on the average from 25.9% since 1925 to 50% in the period 1931—45, was a severe blow to international trade at a time when the world was looking towards the United States for initiative in resuming the lost freedom in that field. The most curious line of policy, however, was the solicitude of the administration towards business as expressed in the creation of the Reconstruction Finance Corporation in 1932, coupled at the same time with the strange apathy and indifference that the administration showed in dealing with the problem of the unemployed. The theory of the administration was that by reopening the channels of credit, the RFC would indirectly help the distressed labor, since it will encourage private business to expand its employment. The extent to which the argument was far-fetched becomes clear when one attempts to analyse how indirect such a method was liable to be. In the meantime, workers and their families were in urgent need of the bare necessities of life. No wonder, therefore, that some contemporaries called the administration's policy "the theory of feeding the sparrows by feeding the horse." [1]. Resentment againts this policy, was in fact strong. And reliance on private philanthropy, on local relief, or on such schemes as "back-to-the-land" schemes, was obviously inadequate. The "bonus bill" was defeated, and the public works that the administration ventured to undertake were on an ineffective scale. The result of the administration's obstinate clinging to its ideals in the face of the harsh facts manifested itself in the presidential elections of 1932 where Hoover was rejected.

While this was going on in the United States, England had already embarked on many of the devices that were later to characterise the New Deal.[2] In May 1931, the Boden Creditanstalt in Austria became insolvent, and the situation was not temporarily saved until the of Bank England and the Bank for International Settlements had given assistance in the form of loans, and until the foreign creditors had accepted a two-year Standstill Agreement. However, in June of the same year, trouble appeared again, this time in Germany. Germany was suffering drastically from the world depression, which had hit her even more severely that it did England or the United States.[3] In such circumstances, the burden of reparations must have been unbearable. The Young Plan disappointed expectations as to the extent of the relief that the new plan would offer. In fact, Germany's total liabilities were reduced only to 26.5 billion dollars, while the "annuities during the early years represented a reduction of of approximately 30% as compared with the standard Dawes annuities".[4] In addition to these critical elements, when President Hoover proposed his Moratorium on June 20, France hesitated long enough to tip the balance against confidence in Germany's ability to carry out her obligations, with the result that foreign creditors rushed on the German banks to withdraw their short term credits. In July 1931, therefore, the Danat Bank closed its doors and Germany in her turn negociated a Standstill agreement. This being done, England now started to suffer a drain on

1. Mitchell *op. cit.*, p. 88.

2. See a journalistic comparison by H. J. Whigham, *The New Deal English and American*, 1936.

3. See Schumepter, p. 921 ff.

4. See Moulton and Pasvolsky, *War Debts and World Prosperity*, 1932, ch. 10.

her gold. The reason for this was that England had a large amount of short term credits invested in Germany, which were now entirely frozen. Frightened about the fate of their foreign credits to England, foreign creditors therefore started to withdraw their money. Traditional methods that used to enable England to withstand a gold drain proved to be entirely inadequate. The discount rate as a tool broke down, and the more it was raised, the more this was taken as a sign of distress. Credits from the United States and France were insufficient. On September 21,1931, therefore, England went off gold — a step, some pointed out, that the United States did not take until the reign of the New Deal in 1933. The internal effects of the abandonment of the gold standard were not as marked as the external effects. The reason lies of course in the previous overvaluation of the pound. The pound remained freely fluctuating however only until April 1932 when the Exchange Equalisation Fund was established. In the meantime England imposed a temporary import duty of 50% on a long list of commodities and the Treasury banned loans to foreigners. The temporary duty however gave place in 1932 to the Import Duties Act, which imposed duties ranging from 10% to 33% and by which England decisively discarded the principle of free international trade. The act was followed by the policy of Imperial Preference included in the Ottawa Agreements in 1932, by which England agreed to continue to exempt empire products from the duties of the act in return for increased preference for British products in the dominions over foreign products.

With England off the gold standard, many other countries soon followed. Among the first came the agricultural countries which had been harder hit by the depression because of the greater fall of the prices of primary products. But many others like the Scandinavian countries, Japan and South Africa also followed. Other countries which did not formally abandon the gold standard, instituted a system of exchange controls which in fact took them off gold. There remained however a small number of countries which retained the gold standard in its true form, and these formed the "gold bloc" which included at the beginning the United States, France, Switzerland, Holland and Belgium, but which was not destined to last for very long as we shall see. Among the countries which instituted exchange controls, Germany was the most important. The mark was suffering from a weak international position. Instead of resorting to straight-forward devaluation by abandoning the gold standard, Germany subjected the use of foreign accounts to various restrictions depending upon the source of the account.

This restriction on the use of these so-called "blocked accounts" is in fact equivalent to an outright devaluation since it reduces their value to the foreign holder. The degree of devaluation however depends on the extent of the supply and demand for each particular category of accounts, a characteristic of the system which put in the hands of the authorities a tool of discriminating control that they could not have enjoyed had they resorted to direct devaluation of the monetary unit. Germany during this period was in fact rushing headlong into the State-directed economy of Hitler. Under the impact of the tangled German situation, Chancellor Bruning resigned in 1932, only to leave the door open to Hitler and the Nazis. The problem of reparations was in fact attacked once more in the Lausanne Conference in 1932, and this time the conference realised the gravity of the situation and the settlement arrived at completely obliterated over nine-tenths of Germany's previous liabilities. "For all practical purposes, the reparations problem (might) now be considered entirely removed as an element of strain in the economic and financial affairs of the world." [1] But the agreement was never ratified for the response of the United States in the matter of interallied debts that was hoped for was not forthcoming. And so reparations and war debts were left unsettled and soon to be all unpaid through default.

Side by side with this unfortunate state in the major countries of the world, Russia in her isolation was vigorously carrying out her five-year plan of 1928. Private property was liquidated and agriculture was socialised, and the country diverted a considerable portion of its resources for building up its capital. Of course this policy involved a great deal of hardship for the people; but the task was also a formidable one. And while other countries were suffering from unemployment and reduced production, Russia was enjoying a rapid and continuous expansion that was soon to bring her back to the rank of a major world power. It is not a surprise therefore that subsequent developments in other countries which tended towards economic nationalism were in fact greatly influenced in one form or another by the Russian experiment. One major country, nevertheless, chose the easier way out of her troubles —the way which the world chose later on in 1939— the way of aggression. In 1931, Japan took advantage of the engrossment of Europe in her financial crisis and invaded Manchuria. Nobody at that time probably suspected that this was only the beginning of a sinister story of conversion to the same policy.

1. Moulton and Pasvolsky, *op. cit.*, p. 362.

The final battle between international cooperation and economic nationalism was not fought until the middle of 1933. But international cooperation unfortunately did not have a chance. For in March 1933, President Roosevelt had already taken office and by the end of April of the same year the United States was off the gold standard and was deeply committed to a purely domestic policy of price inflation. When Roosevelt took office, the first thing that he was confronted with was the banking crisis of 1932-33. American banks, especially the small banks in the small towns and in the rural areas, had been subject to heavy mortality since the postwar depression of 1921. In 1930, however, the rate of mortality suddenly more than doubled, and reached a peak of 2,298 in 1931. One after the other, "bank holidays" were declared in the different states with Nevada leading the way in October 1932. On inauguration day, March 4, 1933, the states that had resisted the temptation finally declared bank holidays too on appeal from the Treasury. And on March 6 the president himself declared a four-day bank holiday under the authority of the Trading with the Enemy Act. After this, steps were taken in rapid succession. On March 7, member banks of the Federal Reserve System were required by the Treasury to deliver all the gold and the gold certificates to the Federal Reserve banks. On March 10, an executive order required permission for all export of gold and dealing in foreign exchange. And finally the gold embargo of April 20, forbade the export of gold unless it was shown to be necessary to promote the public interest. If there was any doubt before as to the intentions of the authorities, it now became clear that the gold standard had been discarded. In the meantime the reopening of the banks had been taken care of by the Emergency Banking Act of March 9, which provided a plan for that purpose. And the ground was now clear for the new administration to start its inflationary policy. On April 28, therefore, the Thomas Amendment to the Emergency Farm Relief Bill provided for the following inflationary measures: (1) The purchase of 3 billion dollars of government securities by the Federal Reserve Banks, (2) or the issue of 3 billion dollars in "greenbacks". (3) The adoption of bimetallism. (4) The devaluation of the dollar by not more than 50%. (5) The acceptance of silver in international debt payment at the rate of 50c/ ounce up to 200 million dollars when the market price was only 40c/ ounce. (6) The power of the Federal Reserve Board to change reserve requirements. Thus the Thomas amendment represented a clearcut choice of purely domestic means of national recovery as against methods of international cooperation, and the issue was already decided before the London Economic

Conference was held in June 1933. The object of the conference was to reduce the tariff barriers. Since, however, this reduction would be useless by itself if the different countries were free to engage into competitive currency devaluation, the conference had to aim in addition at a cerain measure of monetary stability. This was the rock on which the conference was wrecked. For as we have seen the United States was obviously committed to oppose such recommendation. The result was that the conference collapsed, and the last effort for international cooperation was a failure. The stage was set for the different attempts by the various nations to attain recovery through national policy.

VII

In the United States, the New Deal combined measures for recovery with measures for reform in attacking the various sectors of the economy. One of the obvious sources of trouble for the American economy was its banking system which had just emerged from the financial crisis of 1932-33. After the urgent problem of reopening the banks had been dealt with by the Emergency Banking Act of March 1933, attention became diverted to reform which was provided by the Banking Acts of 1935. The first of these acts provided for the divorce of investment affiliates from commercial banks, thus removing a strongly objectionable feature in the banking system which had been a source of unsoundness in the stock market boom ending in 1929. Another source of grave instability was also attacked and removed when the act forbade member banks from making loans to " others " in the stock market. In addition, the act created the Federal Deposit Insurance Corporation and recognised the Open Market Committee of the Federal Reserve System. The act of 1935 aimed at placing more centralised control in the hands of the Federal Reserve Board over open market operations, discount rates and reserve requirements. Reform and regulation were also applied to the stock exchange, another obvious source of trouble, when the Securities Act of 1933 and the Securities Exchange Act of 1934 made unlawful fraudulent practices in the trading of securities and provided for the filing of registration statements and periodic reports by the institutions engaged in dealing in securities with the Securities and Exchange Commission. In these measures, the element of reform was predominant.

The administration was however intent upon pulling the economy out of depression by a policy of price inflation. The abandonment of the gold standard had been a necessary preliminary. This was followed in October 1933 by the gold purchase policy that reached in January 1934 a dollar price of gold of 35 dollars/ounce, which price was taken as a basis for the devaluation of the dollar under the Gold Reserve Act of 1934. The same policy was followed with regard to silver under the Silver Purchase Act of 1934. The act directed the secretary of the Treasury to buy silver at home or abroad until it amounted to one fourth of the metallic stock or until its price had reached 1.29 dollars/ounce. In this case, as well as in the case of gold, considerable amounts of the metal flowed into the United States from abroad to benefit from the high price. Whether the administration was interested in the international effects of such a flow or not, as for instance by considering it a means of increasing the foreign purchasing power in the United States, the international effects were harmful, while the internal effects in the United States were negligible. On the international side of the picture, the drain on the gold of the "gold bloc", and the drain on the silver of China, led the former ultimately to abandon the gold standard, and the latter to go off the full silver standard. In the United States, the effects of the policy in raising the level of prices was slight, for instead of the additional purchasing power being applied in the form of a demand for commodities, it largely accumulated in the banks and "merely found its way into the sump of excess reserves." (Day).

Another method by which the administration sought to put money into the hands of the people was public works. The Public Works Adminstration was created in 1933 and soon after it the Civil Works Administration was improvised as a speedier means of putting men to work. When this latter had been cut off, it was followed by the Federal Emergency Relief Administration which provided a relief program in cooperation with the states. In May 1935, the Works Progress Administration was set up for the coordination of public works programs. The problem of providing employment for the youthful unemployed was dealt with by the Civilian Conservation Corps and the National Youth Administration of 1934 and 1935. The Tenessee Valley Authority had been created in 1933. The theory the administration's activity with regard to public works was that they were intended as a means for "priming the pump", from which point further progress of recovery was to be left to the initiative of private business. It was only at a later stage that the administration became converted to more drastic intervention.

Along the same lines, the administration undertook to increase the purchasing power of the agricultural population which was a weak spot in the economy because of the drastic fall in the prices of primary products. This time, however, the increase in purchasing power was not to be attained by providing additional employment but by a policy of limiting production in order to attain a higher price level for agricultural products. The method adopted by the Agricultural Adjustment Act of 1933 was that of "domestic allotments" and the object was to restore to agriculture the purchasing power of agricultural commodities that was prevalent in the base period 1909-1914. Direct payments were made to farmers who agreed to reduce their output, and these payments were financed by a tax on primary processors. When the reluctance to restrict output became stronger, compliance was enforced through Control acts which levied a heavy tax on output giving farmers tax exempt certificates only to the amount of their assigned quotas. A further method of relieving agricultural surplus was provided by the Commodity Credit Corporation in 1933 by giving farmers commodity loans, without recourse, to help them hold surplus production off the market. The financial success of one of these loans, the first corn loan, led to the advocation of the policy of an "ever-normal granary" by establishing a national stock pile of agricultural commodities that can be used to even out the fluctuations in agricultural prices.

The same policy of the restriction of output for the purpose of raising prices was also followed in the industrial field. Under the President's Reemployment Agreement of July 1933, signers agreed to conform to a minimum wage of 40c/hour and to shorten the week to a maximum of 35 hours, and to boycott non-signers. The competitive pressure that such an agreement put on signers speeded the formation of particular codes of fair competition for the different industries under the National Industrial Recovery Act of 1933. The prime criminal in these codes was the price-cutter. And price maintenance and output restriction were encouraged by the sanctioning of collusive devices that used to come under the prohibitions of the Anti-trust laws. Similarly, section 7a of the same act gave a strong impetus to labor organisation by recognising the right of labor to bargain collectively. And later on, when the NRA was declared unconstitutional, the provisions of the section were salvaged by the National Labor Relations (Wagner) Act of 1935. The objective of organisation for the purpose of maintaining or raising the price of labor is also clear.

The theory of helping recovery by raising prices through the restriction of output was the subject of severe criticism especially when it lead to the actual destruction of output as happened in the agricultural field under the "plow-up and the kill". The policy in fact looked extremely queer when output was sacrificed for price while people were in the most dire need for satisfying their basic wants. "It nowhere seemed to occur to them," says Mitchell "that an economy, which for its correction and preservation, demanded such violence to reason, had better be abandoned than revived".[1] The violence to reason was obvious. And yet a great deal of it has in fact to be attributed to the crudeness of the policy. The theories underlying the administration's efforts at revival were such theories as those of Warren and Pearson, and Irving Fisher's commodity dollar. The very nature of the problem at hand was but faintly understood. This was a stage of experimentation in dealing with the problem of depression. Other nations also experimented, and some of them committed even much graver mistakes than the United States, as when Germany chose to pull herself out of depression by her rearmament program. Of course the example of Russia was always there; but none of the democratic countries was willing to go that far in sacrificing freedom for security.

Depression policy in England was in many respects fundamentally different. The difference arose partly from the difference in the English environment and partly from the relative mildness of the depression in England. England had no problem arising from the organisation of her banking system, since about 70% of all deposits is concentrated in the five banking institutions, a characteristic which provided by itself a natural system of deposit insurance. She had no serious disturbances emanating from her stock exchange, because of the prevalence of the sound practices on which the Securities Exchange Act of 1934 in the United States was based. England enjoyed the existence of social legislation including unemployment insurance since the early twenties. Industrial labor in England was well organised and collective bargaining was well established. In spite of these differences, similarity between some of the English depression policies and their counterparts in the United States is not lacking. England went off the gold standard in 1931. A series of controls and regulations dominated in the agricultural field including price guarantee for wheat to ensure a minimum product-

1. *Op. cit.*, p. 180.

ion, a maximum wholesale and a minimum retail price for milk, and import licencing for potatoes. The English Housing Act of 1933 was the word for word model on which the National Housing Act of 1934 in the United States was based. The former act was in England a strong encouragement for the house building boom which was the largest factor in English recovery. In spite of all this similarity, however, the insistent policy of price inflation that the United States followed had no counterpart in English depression policies. In addition to this, England deliberately dropped public works as a measure of alleviating unemployment. Public works were considered by the government as an expensive method of relieving unemployment which the resources of the national government could not afford. Thus after an initial stage of experimentation with public works, they were virtually discontinued since 1931 and the government instead relied on a nationally supervised system of unemployment relief, on the nationalised unemployment insurance system, and secondarily on methods of transferring workers to the more prosperous areas or to other countries of the empire.

In contrast to both England and the United States, Germany sought to attain recovey through her armament program. With the inauguration of the Hitler regime, the State worked diligently to put the German economy under its control.[1] The various devices of exchange and trade control : blocked accounts, bilateral trade and barter agreements, clearing agreements, which had been introduced after the financial crisis of 1931, became a permanent feature and an integral part of the system of controls. The whole system was then marshalled to satisfy the needs of rearmament. Again the Reichsbank was utilised as the tool through which the financing of the program was to take place. Special bills were drawn by the armament firms on dummy government organisations and used for discounting with the bank. And the German banking system was 'encouraged' to invest its idle funds in these special bills. Long term capital was acquired through an embargo on industrial shares and bonds and in some cases through the direct allocation by permits.[2] Schacht seems to have collaborated with the program as a temporary measure, until it ensured to Germany the position of a strong European power. But the developments of the program proved that he was wrong.

1. See L. Hamburger, *How Nazi Germany Has Controlled Business*, 1943.

2. See A. Schweitzer, "Schacht's regulation of the money and capital markets," *Journal of Finance*, 1941, pp. 1—18.

VIII

The course of the recovery was much the same in most countries, except for the countries of the gold boc, which did not experience any recovery and had finally to suspend the gold standard. An index of industrial production of the Leage of Nations taking February 1933 as its base estimated in 1936 a recovery of 49.2 % for the United States, 38.7 % for Japan and 35.2 % for England. The same index shows an increase of 79.2 % for Germany which was recovering much faster under the impact of her armament program. The suffering of the gold bloc is illustrated in the same index by the figures for France and Holland in which industrial production in 1936 was below the level of February 1933 by 3.9% and 8.3% respectively.

The world, however, had scarcely had enough time to enjoy recovery when the 1937 recession appeared. Stocks of primary products which had been declining steadily since 1932, began to accumulate again in 1937. At the same time the index of world manufacturing started to decline. The decline in manufacturing was, however, "pratically limited to North America, particularly the United States." [1] The output of manufacturing and mining in the United States declined in January 1937, recovered until May, but finally fell by about one third until the middle of 1938. Factory employment too after having reached a maximum in the second quarter of 1937, started to decline and fell from July to December by 14%. Conditions of extreme monetary ease had been predominant in the period preceding the recession and in the fourth quarter of 1936 there was a violent rise in wholesale prices which was not a sign of prosperity but rather of inflation. Some writers have attributed the subsequent recession to the fear of intervention to stop the inflation when the President declared that prices, especially those of durables, were too high.[2] Others considered it a manifestation of the secular stagnation of private capitalism. Schumpeter, however, who characterised the developement after 1935 as the "disappointing Juglar" because it does not conform to his calculations, prefers to look on the 1937 recession as an outcome of the hostile social atmosphere created by capitalistic development. "Capitalism produces by its mere working, a social atmosphere ... that is hostile to it, and this atmosphere in turn produces policies which do not allow it to function".[3] Among these

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1. League of Nations, *Wold Production and Prices,* 1938 — 1939.
2. See Day, *op. cit.,* p. 144.
3. *Op. cit.,* p. 1038.

policies he enumerates, the heavy burden of direct taxation emanating from the Revenue Act of 1934, the labor policies which reduced investment opportunities by forcing up the wage rates, the expectation of competition from government power plants, and the limitations imposed by the Public Utilities Holding Company Act of 1935; and finally the hostility towards monopoly power. Whatever the real cause of the recession, it became part of the darkening skies of the late thirties. Confidence in currency stability was lacking, although the Tripartite Agreement between England, France and the United States in 1936 helped to restore some of the vanished confidence. Political tension was increasing and war was already scorching China and Spain. The problem of unemployment had not been adequately solved, for Britain entered 1939 with the still distressing number of unemployed of 1.8 million; and the United States had 5 million unemployed as late as the beginning of 1940. The failure of the world to solve its major problem was as ironical as the path which finally did bring about a solution : war and destruction.

IX

In their wrath or despair, many have preferred to pour their condemnations on the economic sÿstem and its defects. And yet, how far can this be the source of world problems? From the account that has been give above, it seems that the share of actions in the responsibility is indeed substantial. If anything is clearly illustrated in the developments of the interwar period, it is the haphasard, hasty character of the actions undertaken. Will a similar tragedy be reenacted in this post-World War II world? One hopes that this will not be the case. Men have at least acquired better understanding of the underlying mechanisms of the world and the national economies, and the pressure of the times may therefore become less crushing. What will happen however, will have to be left for time to decide.