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ECONOMIC SURVEY

1919-1939

by

W. ARTHUR LEWIS

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CHAPTER II

1918–1925

CONDITIONS at the end of World War I were so much like those with which we have become familiar at the end of World War II that we need no detailed picture to bring them home to us. On the whole, they were not so bad as conditions in 1946, although of course to their contemporaries they seemed quite catastrophic. The French, for example, were appalled by the physical destruction in their country. They estimated that 2,700,000 people had been driven from their homes; that 285,000 houses had been destroyed and 411,000 houses damaged; that 22,000 factories, 4,800 kilometres of railways, 1,600 kilometres of canals, 59,000 kilometres of roads and 3,337,000 hectares of arable land had been rendered useless; and so on.[1] But the world destruction done by the 1914 war was small compared with that done by the war of 1939; it was more or less confined to a gash five miles wide across France and Belgium, and it was made good with astonishing speed. There are closer parallels in other spheres. The collapse of Germany as an economic unit on this occasion compares with the collapse last time of Russia and of the Austro-Hungarian empire, with the hunger, exhaustion, bewilderment and economic and moral disintegration, which on both occasions made the organisation of relief measures so urgent a task. There was also, in the political arena, the same sense of hopelessness produced by the immediate outbreak of quarrelling and suspicion between the victors over the fate of the vanquished, with the additional complication last time that war continued in various parts of Europe for some years after the main conflict was over.

RELIEF

Then as now, relief seemed the most urgent task. In its later

stages the Allied blockade had done its work well. By the end of 1918, and even before the end of the war, the peoples of Central Europe were starving, and agricultural output was so low that there was no prospect of their being able to feed themselves for a long time. Russia, also, was in an exhausted state owing to the civil war and the decline of production. The first task of the Allies was thus to bring food to the peoples of Europe, allied, neutral and ex-enemy.

The organisation and finance of relief is an important study, but one which we need not now pursue in detail.[2] The work was done mostly by the American Relief Administration, which was created early in 1919 by the United States Government and which served also as the executive arm of the section of the Allied Supreme Council responsible for relief, until with the signing of the Peace Treaty in June 1919, the Council ceased to exist. Thereafter the American Relief Administration remained an official American body for some months, and then became unofficial. There were also many other private relief agencies in the field, but their work was overshadowed in volume by that of the A.R.A.

By June 1919, relief deliveries to Europe reached the sum of $1,214,000,000 and in the next four years a further $201,000,000 brought the grand total to $1,415,000,000. For most of this the receiving countries were expected to pay; 29 per cent was sold for cash, and 63 per cent on credit; only 8 per cent was given away.

Magnificent work was done by the A.R.A., and without it the plight of Europe would have been beyond description. The fact that most of its deliveries were on a business footing—for cash or credit—proved of little consequence, as credits were freely granted and, as things turned out, were mostly never repaid, being merged with war debts ten years later. A much graver deficiency was the fact that relief deliveries were confined to foodstuffs and excluded raw materials. Most of Europe was completely denuded of raw materials by the war, and economic life could not be re-established until raw materials were made available to the factories. But the end of the war was followed by a boom, and an acute shortage of raw materials; in the ensuing scramble America, Great Britain and other countries with sound financial resources got the lion's share, and it was not until the slump that the countries of Central Europe were able to get the raw material they needed to reconstruct their economies.

Raw materials was one of the problems discussed at the first post war International Conference (also the first League of Nations conference) held in Brussels in October 1920, when a scheme of international credits was agreed; but by this time the boom was over, and the Ter Meulen plan (as it was called after its proposer) was never actually brought into effect. It was this difficulty over raw materials which caused the relief organisation of our times, the United Nations Relief and Rehabilitation Administration to be instructed not to confine itself to food, but to give equal priority to the materials needed for reconstruction.

BOOM AND SLUMP

In Western Europe and the United States there was no such acute distress as in Central Europe. Here the problem was simply that of reconversion from war to peace. Millions of men were anxious to be released from military forces, and to be reabsorbed into industry; and factories which had been engaged on munitions had to be converted to civilian needs. As the war neared its end considerable apprehension had been felt lest the process of reconversion should prove prolonged and painful. Many persons expected that the curtailment of war demands would produce a slump, and in this context there was considerable discussion of the future of wartime controls. For in the first world war, as in the second, a whole network of controls had been built up and in a number of industries, e.g. railway transport, coal and munitions in Great Britain, the Government itself was actively engaged.

Fears of a slump proved to be unfounded. For a month or two after the Armistice there was uncertainty, and a slight recession, but by March 1919 this gave way to a boom of astonishing dimensions. In Great Britain prices had risen during the war at a more or less even rate; as Chart I shows, they shot up in the next few months to heights which would not have been thought possible. This was unfortunate in many ways; but the favourable effect of the boom was to simplify immensely the switch over from war to peace. Factories were deluged with orders, and in turn absorbed labour rapidly. Demobilisation was thus speeded up; within five months of the Armistice Britain had demobilised two million men; four million were out by the end of the year, and there was virtually full employment. The experience of the U.S.A. was similar. Both countries also, in this atmosphere, grew impatient

of restraints. Business men demanded the end of controls, and the process of decontrol was greatly accelerated.

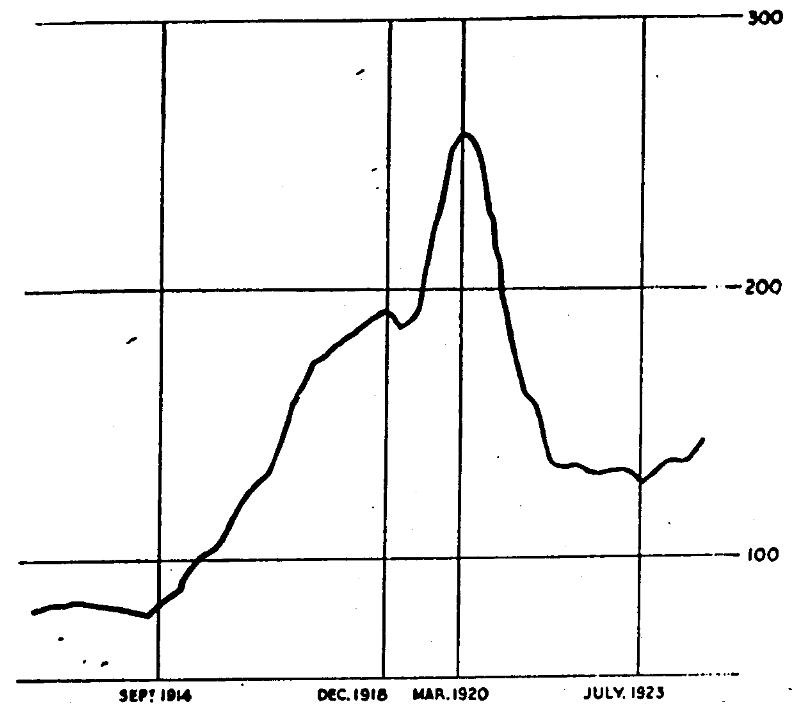

CHART I. WHOLESALE PRICES IN THE U.K., 1912–1923.

The main cause of the boom seems to have been a universal desire to replenish stocks. All over the world larders, wardrobes, and shops were empty; all over the world, too, purchasing power had accumulated. The rush to replenish drove prices up. Moreover, additional purchasing power continued to be created, as Governments were still maintaining expenditure at high levels, retaining wartime practices of deficit budgeting. Governments were also anxious to keep interest rates low so that short term debts could be converted to long on favourable terms. The boom collapsed when raw materials and foodstuffs, which had accumulated overseas during the war for lack of shipping, began to arrive in Europe; when factories began to meet the accumulated demand; and when financial authorities, desiring to check the

speculative inflation, took steps to restrict credit. Prices began to fall in March 1920, and within the next two years, were halved.[4] The year 1921 was thus a bitter year for the world. The boom had raised hopes that the problems of reconstruction could be minimised by a high level of economic activity. But instead, with the slump, men were standing idle in millions, industrial unrest was high, and the future was black and uncertain. The magnitude of the task still to be accomplished was obvious.

EASTERN EUROPE

One of the areas of greatest dislocation was Eastern Europe, whose countries had failed to get securely on their feet again. Several new countries had come into existence. The old Austro-Hungarian Empire had been torn asunder; three new countries, Austria, Czechoslovakia and Hungary had been formed out of it, and parts of its territories had been added to neighbouring states. The peoples of Eastern Europe were hungry, and physically and spiritually exhausted. The railway system was in a sad state of disrepair, as Table I shows.[5]

TABLE I

PERCENTAGE OF RAILWAY ROLLING STOCK FIT FOR SERVICE AT THE BEGINNING OF 1920

Country	Locomotives	Wagons
Austria	63	67
Baltic Countries	"situation chaotic"	
Bulgaria	37	56
Czechoslovakia	62	88
Greece	76	86
Hungary	27	76
Poland	70	90
Roumania	29	57
Russia	15	20

Governments and administrative systems were in chaos, having in many cases to be created virtually from nothing.

To all this was added the consequences of a fierce nationalism. Austria and Hungary were disliked by the peoples liberated from their rule, and these peoples set out to make their economies as independent of these two countries as they could. New currencies were adopted to replace the Austrian crown. The Austro-Hungarian railway system was disintegrated; each country seized the fixed equipment and rolling stock within its borders, and as for

some time no country was willing to allow rolling stock to cross its border, fearing that it would be seized, goods had to be unloaded and reloaded at frontier stations, this adding greatly to cost and inconvenience. In any case, for some time, trade was virtually prohibited. In each country imports and exports were prohibited except under licence, and as food and raw materials were so scarce, very little was allowed to cross frontiers until the boom was over.

The Austro-Hungarian empire had been a single economic unit covering a large free trade area. Now it was split into a number of countries each with its own currency and tariffs. The railways had been constructed with Vienna and Budapest as centres. Now each country remodelled its communications, to turn upon its own capital. Industries in one part depended on raw materials from another. Now the raw materials were kept, and efforts made to foster local industries, while men and materials stood idle in what was now a different country. For example, "Austria was left with sufficient spinning mills and finishing works, but with too few looms. At the same time Czechoslovakia, where the weaving mills were located, gave protection to an infant spinning industry, and so cut off the natural outlet for Austrian yarn. Austria's famous tanneries lost their sources of skins and tanning materials; her Alpine iron works lost their coal—about half of the old coal fields having gone to Czechoslovakia and Poland. Czechoslovakia contained a high proportion of the old Austrian industries, but not a population large enough to absorb their products. Hungary's great flour mills lost both their sources of supply and the market for their products. The industries in Slovakia decayed because the favours and support they used to receive from Budapest dried up."[6]

The strangulation of trade by import and export prohibitions was felt to be one of the most serious obstacles to economic recovery, and attracted international attention at an early stage. Most countries in Europe, including Great Britain, emerged from the war with trade prohibitions, but they were soon relaxed in most places, except in Central and South-east Europe, where they were incorporated into the nationalist policy. In 1920 the Brussels Conference recommended that trade should be freed from such restrictions. In 1921 the Central European States signed a protocol at Portorose engaging themselves to abolish import and export prohibitions, but the protocol was never ratified. A further

international conference, at Genoa in 1922, similarly pronounced against prohibitions, but without much effect. The Central European States gradually abolished some prohibitions, replacing them by high tariffs, but many remained, and the subject was to come up again at international conferences until the end of the 1920's, when the hope of abolishing prohibitions was finally abandoned.

In the meantime, the effect of the nationalism of the new states was to make untenable the economic position of Austria and of Hungary.

Austria collapsed first. Vienna had been the administrative capital of an empire. When that empire disappeared, a vast number of civil servants became superfluous; and their numbers were swollen as the new states dismissed and repatriated the Austrian civil servants in their territories. Vienna had been also a financial and business centre for the empire, and the same thing happened to thousands of commercial employees whose services were no longer required. 1919 saw a high level of unemployment and no prospect of putting people to work. The government had to provide relief, and had in addition, to find money to try to establish itself, and the country. Unable to balance the budget, it borrowed, and printed paper money, and soon a substantial inflation was under weigh. Prices rose phenomenally, and the exchange value of the crown dropped until the end of August 1922 when the dollar exchanged for 83,600 crowns instead of the par rate of a little under 5 crowns.

A good part of the depreciation of the external value of the crown was due to the heavy adverse balance of payments. Austria needed food, raw materials and manufactures, and had little to offer in exchange. As early as 1919 Austria appealed to the Supreme Economic Council for assistance. Various credits were granted, but they were insufficient to meet the needs of the country. Eventually in 1922, when the crown was virtually worthless, the League of Nations arranged an international loan on condition that Austria's finances be subject to international control.

The League of Nations regime lasted until 1926. The budget was balanced, by severe cuts in expenditure and increases in taxation. This forced the Austrian economy to begin to adjust itself to the new situation in Central Europe, a painful process, as a fairly high level of unemployment bore witness. However,

prices and the external value of the currency were stabilised, a[nd] a new currency unit, the schilling introduced. By 1926 conditio[ns] were stable though not prosperous, and League of Nations contr[ol] was withdrawn.

The same fate attended Hungary. Here, in addition to the di[s]location of losing its share of an empire, there was revolution [in] 1919, a communist government for a few months, counte[r-]revolution and a short war. There followed an inflation of the sa[me] magnitude as that of Austria, the external value of the curren[cy] falling to one-hundreth of one per cent of par. Eventually ea[rly] in 1924, the Austrian plan having proved successful, the Leag[ue] of Nations arranged a loan, and its Commissioner took ov[er] Hungary's finances, balancing the budget and restoring stabili[ty]. His regime lasted until 1926.

THE GERMAN INFLATION

Austria and Hungary were not the only two countries wi[th] whirlwind inflations, reducing the value of the currency almo[st] to zero, and necessitating the establishment eventually of a ne[w] unit. Russia, Poland and Germany also had the same experien[ce]. At the end of the inflation prices had risen in Austria 14,000 tim[es] compared with their pre-war level; in Hungary 23,000 tim[es]; in Poland 2,500,000 times; in Russia 4,000 million times; and [in] Germany one million million times. The German case is [an] instructive example of the process.

A runaway inflation may derive from three sources. First it m[ay] be due to upward adjustments of wages, e.g. under trade uni[on] pressure. As wages rise, prices rise. The advantage of the increa[se in] money wage is thus largely offset, and a further wage increase [is] demanded. This leads to a further rise in prices, and the cy[cle] may continue unchecked. Secondly, it may be set in motion by [the] depreciation of the foreign exchange value of the currency, [e.g.] because of an adverse balance of payments. This raises the cost [of] imports, and therefore the cost of living. Wages then rise, if link[ed] to the cost of living, prices rise further, and the foreign excha[nge] value falls still more, setting the cycle in motion. Thirdly it m[ay] be due to a budget deficit financed by increasing the amo[unt] of money in circulation. If money increases faster than the volu[me] of goods (and this is inevitable after full employment is reache[d]) prices rise. This makes the government need more money,

issue of which causes prices to rise still more. It also causes trade unions to press for higher wages, and the foreign exchange value of the currency to fall, each of which enforces the inflationary trend.

The German inflation had some of all these elements.[7] Its genesis was the creation of money by the Government to meet its expenses. This had started during the war. After the war the budget deficits were greater than ever, and prices rose even faster. To help things along, there was also an adverse balance of payments because Germany could not export enough to pay for her imports. This gap caused the exchange value of the mark to fall, and the fall was especially great in September 1921 after a particularly heavy reparation payment. Budget deficits, an adverse balance of payments, and rising money wages all contributed to make the greatest inflation in history. Taking average wholesale prices in 1913 as 100, the following prices for December of each year show what happened (Table II):

TABLE II

WHOLESALE PRICES IN GERMANY, 1918–1923

Dec. 1918	245
Dec. 1919	800
Dec. 1920	1,400
Dec. 1921	3,500 > 42×
Dec. 1922	147,500 > 854 million ×
Dec. 1923	126,000,000,000,000

In the early stages of the inflation, the rise of prices does not seem to have stimulated as much protest as one might have expected. This was partly because inflation creates its own vested interests. The Government, beset with its problems, and having a very uncertain basis—the defeat was followed by attempts at revolution, much social unrest, and uneasy coalitions—found it easier to carry on by creating new money than to face the unpopularity of raising taxation. The industrial and mercantile classes also benefited from rising prices, because, by the time they came to sell what they had bought, the further price increase had added to their profits. And, so long as production was so profitable, there was an unsatisfied demand for labour, and unemployment virtually disappeared; the trade unionists occupied

themselves with trying to secure that wages should rise as rapidly as prices, and did not, in the early stages, view the price increase with great alarm.

The final blow came in 1923. In January of that year the French Government, which had long been disputing with the Allies over the amount to be extracted from Germany, claimed that one of the reparation payments was in arrear, and sent troops to occupy the Ruhr. The German Government's reaction was passive resistance; the inhabitants of the Ruhr were urged to strike, and to support them the Government was forced to print ever increasing quantities of money. By the end of 1923 prices had risen to such fantastic heights—e.g. the price of a newspaper rose to 200,000,000,000 marks, the par value of a mark being about one shilling—that the mark was practically valueless and people were ceasing to use it.

An inflation of this magnitude has a number of interesting features which are worth recording.

(a) One feature was that prices were affected in different degrees. Some prices are more flexible than others. For example, as railway charges were adjusted less rapidly than many tramway charges, it was frequently cheaper to travel from one town to another than from one street to another. Rents moved very slowly, and so did salaries. Wages moved slowly at first, and the workers lost through inflation; but after a while wage rates were tied to changes in prices. Bye and large wage earners lost a little from the inflation, and manufacturers and traders gained considerably. The heavy losers were pensioners and the middle classes, who lost both because pensions and salaries were left lagging far behind prices, and also because their savings were virtually wiped out.

(b) Middle class savings were wiped out because they were usually invested in loans which could be repaid at their nominal value, and that value became negligible. Creditors benefited at the expense of debtors. In fact for all practical purposes debt disappeared. This wreaked great hardship on persons dependent on their savings, including retired persons, and on institutions like philanthropic societies dependent on endowments. After the inflation legislation was passed to write up the value of debts; but only some debts were affected, and the writing up still left them at only a fraction of their real pre-inflation value.

(c) One result of the profitability of commercial enterprise was

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to make capital extensions profitable. Farmers bought machinery; industrialists built factories, and so on. So great was the boom in investment that labour was attracted out of the industries producing consumers' goods into those producing investment goods, which were accordingly swollen. Many business men also invested their profits in trying to create commercial empires by buying up other concerns and forming combines. When the inflation ceased this in due course produced a crisis; the swollen investment goods industries lost part of their market, and many unsound firms went bankrupt. The increase in capital construction was associated with the shift of income tc the entrepreneurial classes. Savings increased and consumption declined.

(d) Side by side with the increase of fixed capital there was a decrease of working capital, i.e. of stocks and of work-in-progress. Goods were snapped up as soon as they reached the market. For the economic system as a whole stocks remained the same, or increased, but the share of the stocks held by users increased, and the share held available centrally to all buyers, whether in shops or in the hands of wholesalers, diminished. There were many complaints that this exhaustion of stocks hindered the smooth flow of production.

(e) In the early stages foreigners noticed how cheap the cost of living in Germany became for them. Many went to Germany at this stage and bought valuable property for very little, causing some Germans to complain that foreigners were "buying up the country." The reason for this was that the external value of the mark, its value in terms of sterling or dollars, fell more rapidly than internal prices rose. This was due partly to the passive balance of payments, including reparations, and partly to the fact that foreigners and German financiers realised what was happening sooner than the German public in general (not because of greater intelligence, but because the people who deal in foreign currencies understand these matters better than the man in the street). As soon as the German people themselves realised what was happening, the gap between internal and external values decreased. Prices rose as fast as new money was printed and even faster.

(f) Prices rose faster than the quantity of money in the later stages because people expected the value of money to go on falling and got rid of it as fast as they could—its velocity of circulation rose. In the latest stages prices rose faster than the quantity of money and the velocity of circulation together; prices rose so fast that there was not enough money to buy goods with. It is one of the paradoxes of an inflation that, although it is due to printing too much, it ends with the emergence of an acute shortage of money! The printing presses were working full time, but were unable to print all the money that people needed to buy goods at the inflated prices. The smaller denominations ceased to be issued; at the end mark notes were being printed bearing the stamp 100,000,000,000,000 marks, which at par should have been worth five million million pounds, but which in fact were enough to buy only about 2,000 loaves of bread.

(g) The shortage of money caused firms to start issuing their own money in payment of wages. This was preferred because it was issued in stable terms; its value was expressed not as so many marks, but as so many dollars, or grains of gold, or kilogrammes of wheat or rye. This was the last stage in the life of the mark. People began to refuse to accept it, or to use it for contracts. Foreign currencies came into circulation, and prices ceased to be expressed in terms of marks. The currency was simply rejected.

(h) It is this that explains how stabilisation became possible. Prices were not stabilised by drawing money out of circulation; on the contrary, still more money was put into circulation, but it was money which people were willing to accept, and for which there was therefore a great demand.

The mark was stablilised by announcing that a new mark, the rentenmark, would be issued. To encourage confidence people were told that this mark was to be backed by an internal loan founded on the real assets of the country, its land and other property. What mattered however, was that it was to be strictly limited in supply. Once people believed that the wild issue of paper money was to cease, they believed that prices would not rise any more, and they were therefore willing to hold money. The Government was therefore able to issue this money, using it to meet its obligations, and knowing that it would be readily accepted and held. This gave it a breathing space in which to balance its budget. The new rentenmark, valued at one million million of the old marks, was first issued in November 1923, and the Government set about drastically reducing expenditure and increasing taxation. The experiment was successful.

Part of its success was due to the German Government's receiving an international loan in 1924, which marked the beginning of a flood of loans to that country. For the origins of this we must trace in outline the history of reparations.

The Treaty of Versailles did not fix the amount of reparations, although it provided for some interim payments in cash and in kind. It established the principle that Germany should indemnify the Allies for their losses, and created a Reparations Commission to assess the amount. In 1921 the Commission assessed the damages at a sum equal to 6,600 million pounds sterling and laid down a time schedule of payments. It soon became clear, however, that Germany could pay nothing approaching this sum, and indeed, by 1922, with the inflation well on the way, was so disorganised that for the time being she could pay very little, and rather needed assistance. British proposals for a moratorium were fiercely resisted by the French, who were depending on reparation payments to help reconstruct their devastated areas, and in the general deterioration of international relations which ensued, France in January 1923 occupied the Ruhr.

With the collapse of the mark, which this occupation then stimulated, it became quite obvious that Germany could pay very little. Emphasis shifted from arguing about what she ought to pay, to estimating what she could pay, and a Committee under the American General Dawes was appointed to report on this. On its recommendation, Germany was required to pay a sum rising in five years from 50 million to 125 million pounds per annum, the number of years of payment being left undetermined. The first payment was facilitated by raising an international loan of 40 million pounds (the Dawes Loan) whose proceeds went towards it. After this loan foreign countries began to be interested in the reconstruction of Germany, and for the rest of the 1920's both the Government and private firms were able to borrow large sums abroad. Comparative stability had returned.

Stabilisation, however, had its costs. So long as money was continually injected into the system, economic activity was maintained at a feverish level. When credit began to be curtailed, to ensure stabilisation, the boom conditions of inflation collapsed. The reaction was, actually, delayed. Towards the end of the inflation economic conditions had deteriorated because of the virtual uselessness of money, and 1924 brought renewed confi-

dence. Factories reopened, and unemployment declined. Re-adjustment did not begin until the second half of 1925. When it came, the heavy industries were affected most. We saw earlier that the inflation had caused the producers' goods industries to expand at the expense of the consumers' goods industries, because of the anxiety of profit makers to convert cash into fixed capital. This desire lost its *raison d'être* when prices ceased to rise, and pressure on these industries relaxed, with a consequent increase in unemployment. It was here too that the biggest combines had been created. Many of these proved to be unsound. The liquidation of "inflation" businesses began in 1925 and continued in 1926. Germany did not really begin to recover from the inflation until the middle of 1926.

RUSSIA

The economic collapse of Russia was even more spectacular than that of Germany or Austria or of any of the other countries with whirlwind inflations, for in other countries it was principally the currency which collapsed, whereas in Russia it was production as well.

The economic history of Russia since the Revolution falls into distinct phases, and much confusion is caused by thinking of communism as a simple well defined type of economic organisation. The form which communist economic organisation should take had never been specified by Marx, and neither Lenin nor Stalin ever attempted to give it detailed finality. The single objective of the Russian Government has been to make Russia a strong economically developed country, without private ownership of the means of production, and the economic forms have been changed whenever circumstances seemed to require change.

At the time of the Revolution in 1917, Lenin seems to have intended the process of nationalisation to be gradual. Circumstances, however, forced his hand. Civil war broke out almost at once, and continued for three years, with foreign countries intervening to assist the counter-revolutionary elements. The Red Army was at first driven back on all fronts, and Lenin was compelled to take more drastic steps to control the economy than he had intended. The first three years of the Revolution have therefore come to be known as the period of "War Communism."

The war produced a violent inflation. Prices had been rising

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before the Revolution; they were already eight times the pre-war level when the communists took over. As the civil war proceeded the government issued more and more money to meet its expenses, and production declined; the price index rose from 100 in 1913 to 1,680,000 in January 1921, 13,800,000 in December 1921, and 1,644,000,000 in December 1922, and was not checked until February 1924, when stabilisation was introduced at the rate of 50,000,000 old roubles for one of the new.

In this background of war and inflation nationalisation was pressed ahead. All factories and credit institutions and internal and external trade were nationalised. Labour was conscripted and equality of earnings adopted. Money values were ignored, and requisitioning and rationing took the place of trade. A more thorough form of communism was achieved than had ever been intended, or has ever since been attempted.

Despite the feeling of some communists that this was the ideal state, this form of organisation had to be abandoned. The greatest troubles were with the land. The peasants took over the large estates and redistributed them, output falling somewhat in the process. The government needed food for the towns, but the prices it was willing to pay were well below the inflation level, and the peasants were unwilling to deliver. A vicious circle set in. The government tried to requisition grain; the peasants reduced their sowings; the towns got more short of food and agricultural raw materials; workers returned to their villages in search of food, and factory output declined; the peasants were then even less willing to part with their crops, as the industrial products offered in exchange got smaller and smaller. Rationing had to be introduced in the towns, and famine made its appearance. The official figures tell the story plainly.[8]

	1913	1920
Industrial Production	100	20
Gross yield of crops (1909–13)	100	54

The number of livestock was also greatly reduced. By the end of the war in November 1920, it was clear that there must be a new beginning, as industrial production had virtually collapsed, and with agricultural output getting smaller and smaller the country was unable to feed itself. Accordingly in March 1921 Lenin announced that there was to be a New Economic Policy.

The distinguishing feature of the New Economic Policy was the

restoration of private trading. The state retained a monopoly of production in all the most important industries, while allowing small private factories to operate in not so important ones. But it relaxed almost completely its interest in trade, state factories selling their output to private traders, through whom it reached the consumer. Grain requisitioning was also stopped; the peasants sold their grain in the open market, and taxes in money were eventually substituted for deliveries in kind.

A determined effort was made to stop inflation. A new rouble, the chervonetz was introduced in 1922. At first it circulated with the old, its value being kept stable by careful limitation while the old depreciated all the faster. Eventually in 1924 the chervonetz rouble became the sole currency unit; the budget was balanced, and relative stability of prices was attained.

Private enterprise seized its chance, and certainly achieved results. Production increased rapidly. The peasants once more increased their sowings, and food and raw materials became more plentiful in the towns. Factory wheels started to turn once more. By 1926 industrial production was back to the level of 1913, and if agricultural production was still below the pre-war level, this was because the yield had declined; the area sown was already somewhat larger. The share of private enterprise in this recovery was, however, restricted to restoring the market. Industry and credit continued to be primarily state enterprises; and even the market was gradually being taken over as more cooperative and state trading associations were organised; the share of private traders in retail trade fell from 75 per cent in 1922–3 to 22 per cent in 1927–8.

Our aim at this stage is not to describe the Soviet economic system but rather to consider its impact on the world economy. Here, the spectacular feature was the virtual disappearance of Russia from the international economic scene. Russian exports fell from 1,520 million roubles in 1913 to 1 million roubles in 1920. Thereafter they recovered very slowly, and even by 1929 had not reached two-thirds of the pre-war level. This collapse was due to several features; to the great decline of Russian production in the first four years after the Revolution; to the fact that several countries refused to recognise Russia in the early 1920's or to trade with her; and to the fact that the Russians were unable to obtain foreign loans. Whatever the cause, the principal impact on the international economy was the disappearance of Russian

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grain from the market at a time when many European countries were short of food, and the failure of Russia to import.

THE "MINOR" INFLATIONS

Austria, Hungary, Poland, Germany and Russia were the five countries where such violent inflations occurred that the currency became valueless and new units had to be introduced. There were, however, quite a number of "minor" inflations, not only in Europe, but also in other continents, resulting in the foreign exchange value of the currency being eventually formally devalued. The principal European countries which eventually stabilised their currencies below par were the following: the figures in brackets showing the ratio of the dollar value of their currencies in December 1925 to its par value: Roumania (2.4 per cent), Bulgaria (3.8 per cent), Portugal (4.7 per cent), Greece (6.7 per cent), Jugoslavia (9.2 per cent), Finland (13.1 per cent), Czechoslovakia (14.6 per cent), France (19.4 per cent), and Belgium (23.3 per cent). The only European countries which finally returned to parity with the dollar were Britain, Switzerland, Sweden, Norway, Denmark and Holland.

The experience of France illustrates a "minor" inflation. Taking wholesale prices in 1914 as 100, December prices were as follows, 1921, 333; 1922, 370; 1923, 468; 1924, 518; 1925, 646; 1926, 640. The main cause was the need to finance reconstruction of the devasted regions. Until 1923 it was assumed that the cost would be met by Germany, and the Government borrowed freely instead of increasing taxation. The desired result was certainly achieved; reconstruction was pushed forward rapidly, and after a short recession in 1921, due to the post-war slump, French production forged ahead in a minor boom which continued throughout the 1920's. By 1924 it was clear that Germany would contribute only a part of the cost of reconstruction, and as a result, in 1924 the French public grew afraid of the continued Government borrowing, and the Government found itself suddenly unable to meet its obligations either from taxation or by borrowing. The resultant crisis showed itself in politics and in the foreign exchanges rather than in production. In politics there was a rapid succession of Governments, six ministries in 18 months. And in the foreign exchanges, lack of confidence (to which the fact that these were "left" governments contributed) caused Frenchmen to convert

their holdings of francs into foreign monies, and the franc fell heavily, to levels in no way justified either by internal prices or by the economic situation. Eventually in 1926 a "right wing" ministry under M. Poincaré took stern measures to balance the budget. Confidence returned; refugee capital returned home; the dollar value of the franc rose rapidly, and at the end of the year the Government decided to hold it stable. Formal return to the Gold Standard followed in 1928. The rate chosen undervalued the franc. Compared with 1913 French prices in 1927 had risen four and a half times more than U.S. prices, but the franc had been devalued to one-fifth of its value, and French exports were accordingly stimulated.

The experience of Great Britain and of other countries which returned to parity was very different from this. Their prices had risen during and after the war more than American prices, and after the boom of 1919–20, they found it necessary to deflate in order to get back to parity. Compare wholesale prices in the U.S.A. with wholesale prices in some of these countries (Table III).

TABLE III

WHOLESALE PRICES, 1913–1927

	1913	1920	1921	1922	1923	1924	1925	1926	1927
U.S.A.	100	221	140	139	144	141	148	143	137
U.K.	100	307	197	159	159	166	159	148	142
Sweden	100	359	222	173	163	162	161	149	146
Holland	100	292	182	160	151	156	155	145	148

As their prices had risen to much higher levels than U.S. prices, the required deflation was also greater. Some of them were not able to get their prices right back into line with U.S. prices before returning to the Gold Standard, and they therefore started upon the second half of the 1920's with their currencies somewhat overvalued.

The relative stagnation of Great Britain at a time when several other countries were forging ahead, occasioned particular comment. In the United States a constructional boom got going as early as 1922, and in that country all the years from 1922 to 1929 are counted as a boom period. So also in France, where the expenditure on restoring war areas brought a high level of employment from 1922 onwards, and in Japan, where the earthquake of 1923 was followed by a reconstruction boom.

The slow recovery of Great Britain after the 1920 slump is attributable to two main factors. First, deflation. The decision to return to the Gold Standard at the pre-war rate was taken as early as 1919, and the fairly stringent credit conditions which obtained from the end of 1920 hindered recovery. There was not much deliberate deflation; a budget surplus used for debt redemption, was the principal instrument, and set the general tone.[9] Secondly, although there was a housing shortage there was no housing boom such as occurred in the United States, and this has been attributed partly to the ineffectiveness of local authorities, who then as now were the "chosen instrument", but even more to the joint effect of rent restriction and high building costs, which made new building unprofitable.[10] And thirdly it was due to the changed international position of Great Britain which was to become even more obvious later, and to which we shall refer in the next chapter.

CONCLUSION

The year 1925 is usually taken as the end of the period of reconstruction after the war. It is an apt date, in politics no less than in economics. Up to 1925, in the political sphere, the Allies were still wrangling with each other over the treatment of Germany, and the international atmosphere was as clouded as it is now as these words are being written (October 1946). Not until the acceptance of the Dawes Reparation Plan (1924) and the signing of the Locarno pact (1925) did the atmosphere of mutual suspicion and recrimination disperse. In 1925, Europe seemed at last to close its ranks once more; men ceased to look back to the war and its consequences, and looked forward to a new era of peaceful cooperation.

1925 was just as much a turning point in economic affairs. It was the first year in which the volume of world trade passed its pre-war level, though some of the countries in Western Europe and overseas had passed that level earlier. 1925 was also the first year in which European primary production reached and exceeded the level of 1913; and the year Great Britain returned to the Gold Standard, leaving few important currencies still in a state of fluctuation. Not all countries had fully recovered from the war by 1925, and indeed their fortunes differed considerably in that year. But in economics, as in politics, it was a cheerful year. The dark days of post-war dislocation seemed to have been left behind, and the prospects for progress seemed good.

Naturally the war had altered the balance of economic power. We have a good pointer to the change in the index of manufacturing.[11] Taking 1913 as 100, the index for the world as a whole stood in 1925 at 121, while individual countries stood in the following order:

Japan	222	France	114
Italy	157	Sweden	113
U.S.A.	148	Belgium	100
Holland	142	Austria	95
Australia	141	Germany	95
Czechoslovakia	136	Roumania	92
New Zealand	136	U.K.	86
India	132	Hungary	77
Norway	117	Russia	70
Canada	117	Poland	63

Bye and large, the overseas countries had naturally fared best; not only their manufactures but also their primary production had grown relatively to European production, and so had their participation in world trade. The countries of Eastern Europe share the bottom of the list with the U.K., which was adversely affected by shifting trends of world trade, and with Germany, adversely affected by inflation.

Looking backwards from 1925 one must enquire why recovery was so slow and painful. Why did it take six years to return to an atmosphere of normality?

The physical destruction caused by the war, or other capital depreciation, is not the main answer. In agriculture wartime deterioration was quite important; so much land went out of cultivation, and what remained had so deteriorated in yield that European production did not return to the pre-war level until 1923[12]. But destruction and deterioration of other property was not very large, all told, and recovery was indeed quite rapid in the country where that destruction was greatest, namely in France.

Three factors seem to have predominated—the slump, the shortage of capital in most European countries, and the hindrances to trade.

The slump was the most important. It came too soon after the end of the war—within 18 months, and set back the incipient recovery. The boom had been a commodity boom, based on local rather than on total shortages; it collapsed when stocks of food-

stuffs and raw materials locked up in distant countries started to move to the consuming centres. This is not to say that the preceding boom was in itself desirable; it was the boom that caused the slump, and if the world could have returned to peace with neither speculative boom nor slump, its progress would have been more rapid. But, given that this is a world of ebb and flow, it would have been better if the boom had been less wild and longer, which might have been the case if inflationary financial policies had not pushed prices far beyond what the fundamental demand and supply conditions justified.

Secondly, recovery would have been swifter if appropriate action had been taken to finance the needs of European countries. Their restoration was greatly delayed by shortage of raw materials and by lack of foreign reserves with which to purchase them. Had they received loans sooner than they did, their demand would have been sustained, and the collapse of 1920 might have been delayed, just as the export surplus from the U.S.A. is now playing so large a part in keeping economic activity high. They would also not have had such pressure on their budgets, and the wild inflations might have been avoided. Inflation banished unemployment while it lasted, but when it ended the country experiencing it was in worse straits than it had been before. Foreign loans would have facilitated sound recovery.

International lending would also have diminished the barriers to trade. It would have reduced the pressure on the foreign exchanges and the wide fluctuations which were such a deterrent to trade. It would also, by maintaining production, have diminished the incentive to keep such high tariffs. The war had damaged the pre-war network of trade, and to repair it was more difficult than to repair the physical damage. Factories stood ready to produce, but in many cases either their pre-war markets or their sources of supply had disappeared, and a new trade network had slowly and painfully to be woven. There was full agreement that obstacles to trade, both tariffs and currency fluctuations, should be reduced; international conferences at Brussels in 1920, at Portorose in 1921 and at Genoa in 1922 all recommended to this effect; but without positive help from abroad few countries felt able to relax the controls which each required to protect its internal market.

The need for international lending was widely recognised. The United States and the United Kingdom made fairly substantial

loans, but they went mostly to the countries which were strong and good borrowers rather than to those which were weak and needed loans most; and the League of Nations Reconstruction Loans (Austria 1922, Greece 1923, Hungary 1924, Bulgaria and Estonia 1926, Danzig 1927) were too long delayed. There were many good resolutions passed at international conferences, but good resolutions are not an adequate substitute for financial assistance. The speed of our recovery from World War II will probably depend more than anything else on the measures which the stronger countries take to help in restoring their more unfortunate brethren.

CHAPTER III

1925–1929

FROM 1925 to 1929 the clouds seemed to roll away. The political atmosphere was much better. The Locarno pact signalised the return of international confidence. The suspicions of the war were banished and men looked forward lightheartedly to peace. The economic atmosphere was no less confident. Between 1925 and 1929 world production of foodstuffs and raw materials was increased by 11 per cent and world trade by 19 per cent; world manufacture proved particularly buoyant, increasing by as much as 26 per cent. The times felt prosperous, and so indeed they were.

THE UNITED STATES

The pattern was set by the United States of America. There the boom which had begun in 1922 went gaily on until 1929. There were minor setbacks in 1924 and again in 1927, but on each occasion the recession was mild and short, and recovery swift; 1922 to 1929 can be taken as one fairly continuous boom.

There were several contributory elements. Residential construction started the boom. A housing shortage had been inherited from the war, and construction started with a swing in 1921, aided by a fall in building costs relatively to rents. Factory construction soon followed, to cope with a series of innovations in American industry. In the year when the volume of construction was at its peak, 1927, the expenditure on private and public building was as large as 12 per cent of the gross national income.[1]

The innovations were of two kinds. First, there were many new products to be exploited. Of these the motor car was the most outstanding. The expansion of motors (annual production increased by 33 per cent between 1923 and 1929) gave the lead to

many ancillary industries; to petroleum, to rubber, to steel and to tin; to road construction; and to road transport—to mention only the more obvious. But electricity, with its associated industries of generation (the output of electric power doubled between 1923 and 1929), and the production of a whole range of new industrial and domestic electrical appliances, also made an important contribution.

Apart from new products, however, this was also a period of notable increase in the application of new inventions to old products; there was a considerable increase in the use of capital and of power. Between 1923 and 1929 productivity per man hour increased in manufacturing by 32 per cent, in electricity generation by 39 per cent, on the railways by 18 per cent, and in agriculture by 15 per cent.

Given these opportunities investment maintained a high level. Gross capital formation was as high as 21 per cent of gross national income in 1923, and expanded steadily, keeping this ratio throughout the twenties. Easy credit conditions also kept investment high. Bank deposits increased by 33 per cent and their turnover velocity by another 44 per cent; and the rate of interest declined. A good deal of this money seems to have gone into speculation rather than into increasing output, but the ease with which money was available certainly facilitated the growth of production.

In these circumstances gross national income increased (1923-29) by 23 per cent, compared with an increase in population of only 9 per cent and in the labour force of only 11 per cent. The output of manufactures increased by 30 per cent, and of agriculture by 9 per cent. Unemployment was negligible. In the bad year 1924 it was as high as two millions, or 4.5 per cent of the labour force, but in most other years it was less than 2 per cent. Gross income per head of the population increased by 13 per cent.

Prosperity in a country as important as the United States is bound to spread itself over the world. American imports increased, especially imports of raw materials, and their producers were buoyant. And American loans helped the rest of the world to reconstruct its industry. Between 1925 and 1929 the U.S.A. lent abroad, on long and short term, 2,912 million dollars net, an achievement all the more remarkable because up to 1913 the U.S.A. had been a debtor country.

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The indices show that only two major countries did not share in this prosperity. The index of manufacturing (1913 = 100) for the world as a whole rose from 121 in 1925 to 153 in 1929; in Germany it rose from 95 to 117, and in the United Kingdom from 86 to 100.

GERMANY

The "stabilisation" crisis in Germany lasted from mid-1925 to mid-1926, and was followed by comparative prosperity until 1928. Towards the end of 1928 prosperity began to diminish, and from 1929 a steep decline merged into the worldwide depression.

The prosperity of 1926–1928 was based on reconstruction, financed largely by foreign borrowing. This reconstruction was both private and public. Private industrialists borrowed to reconstruct their plant, on a "rationalised" basis. The word "rationalisation" became very popular in all countries. It referred to two separate processes. One was the building of up-to-date plants, usually of enormous size, to secure the fullest economies of scale; whatever the long run advantage of this, it was to prove very costly when the slump came and German industry found itself burdened with heavy overhead costs. The other process was the elimination of competition by market sharing and similar arrangements. This was designed to eliminate the costs of competitive marketing; at the same time it eliminated one of the incentives to efficient production, and some of the experts who have investigated the German economy since the end of the second world war have concluded that the latter effect was more important than the former. Added to this private industrial reconstruction there was considerable expenditure by public authorities, much of which was strongly criticised because it was "unproductive", i.e. mostly on public buildings, theatres and other social amenities which do not yield an exportable surplus.

This phase of German economic history has not yet received considered appraisal. The general tenor of foreign comment is that there was too much capital investment for a country so short of capital. Net investment was running very high. In 1927 and 1928 it averaged 11.8 per cent. of the national income.[2] This was greatly in excess of what the German people themselves were willing to save, and was possible without renewed inflation only because foreign countries were willing to lend freely to Germany; nearly a half of the net investment was in fact done with foreign

funds. The ease with which Germany was borrowing is shown by the fact that she was able to raise much more than she really needed to finance her adverse balance of payments. According to the official estimate she borrowed abroad between 1924 and 1931 about 30 milliard reichmarks, and according to another estimate[3] as much as 9 milliard reichmarks of this accumulated abroad. But though money was easy to get, it was expensive; short term rates of interest as high as 8 per cent and 9 per cent and more had to be paid. These high rates of interest were bad for the economy, burdening it with debt, and the form of the foreign borrowing was also specially unfortunate in that more than 40 per cent of it was short term borrowing, both industry and the banking system thus becoming dependent on a form of credit which could very easily be withdrawn, and the disappearance of which would cause economic contraction.

This is, in fact, what happened. In 1928 Americans began to withdraw their short term funds for investment at home, where stock exchange speculation had become very profitable, and these withdrawals continued throughout the first months of 1929. After the collapse in Wall Street some money returned. But political confidence in Germany was shaken for various reasons in 1930 and 1931, and heavy withdrawals started again. The result, from 1928, was further contraction of domestic credit; employment declined rapidly and the ensuing depression proved to be worse in Germany than in any other country except the United States.

GREAT BRITAIN

The British experience was different. Here there was not even an interlude of prosperity; throughout there was a high level of unemployment, averaging between 10 per cent and 11 per cent. The causes of this high level, which was between two and three times as high as the pre-war expectation of "normal", provoked considerable discussion. The concensus of opinion among economists was that in returning to the Gold Standard at the pre-war parity in 1925, sterling was over-valued about 10 per cent.

It is true that the depression was centred in the export trades, and that most of the unemployment was concentrated there. And it is also true that exports of these staple industries would probably not have been much higher if the pound had been devalued 10 per cent. Different staple export industries were depressed for different

reasons. The coal industry was depressed principally because new mines had been opened elsewhere, and water power developed, depriving it of export markets. Cotton lost its export markets because of the growth of Indian domestic production and of Japanese competition in the Far East. Iron and steel, shipbuilding and metal trades generally were suffering from wartime over-expansion in Great Britain and elsewhere. In all these staple industries prices were low, and it is doubtful whether devaluation would have helped their exports much.

But the important point is that it might have helped the new industries to expand more rapidly, both by making competing imports dearer, and so reserving the home market, and also by increasing exports. Prices of British manufactures were too high, compared with foreign prices, and the result was to make it difficult for the country to adjust to lost markets by developing new ones rapidly. The need for adjustment was not new. The British share of world trade had been diminishing steadily for several decades before the war, but the absolute volume of British exports had nevertheless been growing all the time. The new phenomenon was that British exports should have lost ground in absolute terms, so that while world trade after 1925 exceeded the pre-war level, British exports remained smaller than before the war. This can partly be attributed to the war, which, by cutting off British exports, caused industrial development in overseas countries to be concentrated on those products which had figured most largely in British exports. But it is also to be attributed to over-valuation, which restricted the adjustment process by restricting the growth of new industries and new exports. This is clear if we compare British experience with that of France, Italy and Switzerland. Taking 1913 as 100, the average of export prices[4] for 1927–29 was France 101, Italy 123, Switzerland 149, and U.K. 162; and the average quantum of exports was France 147, Italy 136, Switzerland 101, and U.K. 85. This leaves no room for doubt that British prices were too high.

Was this also the explanation of the other problem that gave so much concern, namely the difficulty experienced in keeping on the Gold Standard? For most of this period the exchange value of the pound was slightly below par, and the Bank of England experienced difficulty in preventing an outflow of gold. This difficulty was not in the first instance due to an unfavourable

balance on income account; exports and earnings from invisible items were more than enough to meet current liabilities. The cause of the difficulty was excessive lending, in the sense that the sums lent exceeded the current balance available. Monetary institutions in London had been geared to a high level of foreign investment before 1913. After 1925 Britain could not really afford to lend as much as she had been lending before 1913, but the machinery continued as before. More was lent than was possessed. The difference was met by attracting short-term funds to London for re-investment abroad, and this short term borrowing was destined to cause trouble in 1931, when money was suddenly recalled. Nevertheless, this too can be attributed to the over-valuation; for we can say that the trouble was not that Britain lent too much but rather that she had too little to lend. This is merely a difference of formulation. If the price level had been lower she could have lent more without difficulty; but given her price level, she was lending too much.

Meanwhile, the attention of the authorities was concentrated on the over-valuation of the pound, for which they considered that the remedy was not to devalue the pound but to reduce the British price level. Prices were to be reduced not so much by deliberate credit restriction, of which there was very little, but rather by reducing money wages. The attempt to put this policy into practice produced a major social crisis.

Money wages followed more or less the course of the boom, slump and recovery. Taking December 1924 as 100, the index of average weekly wages in the United Kingdom[5] was 115 in January 1919, rose to 155 in January 1921 and fell to 97 in January 1924, after which it rose again. These changes were accompanied by violent labour disputes; the "labour offensive" in 1919 continued long after the boom had broken and in the face of falling prices in 1920, and the disputes, strikes and lock-outs associated with it and with the subsequent "capitalist offensive" which began to be successful in 1921, were extraordinarily bitter and prolonged, and destined to poison industrial relations for another twenty years. The statistics of disputes[6] tell their own story (Table IV):

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TABLE IV

U.K. INDUSTRIAL DISPUTES, 1919–1929

Year	Number of Disputes	Working days lost (millions)	Av. Weekly Wages (Dec. 1924=100)	Wholesale Prices (1913=100)
1919	1,352	35.0	119	242
1920	1,607	26.6	143	295
1921	763	85.9	142	182
1922	576	19.9	109	154
1923	628	10.7	98	152
1924	710	8.4	99	165
1925	603	8.0	101	160
1926	323	162.2	101	150
1927	308	1.2	101	144
1928	302	1.4	100	142
1929	420	8.3	100	134

1921 was the bitterest year; as prices had been falling steadily from the second quarter of 1920, whereas money wages had continued to rise, and were not successfully attacked until the beginning of 1921. Gradually the deflation of prices came to an end, and with it the attack on wages; prices began to move up in 1923, and money wages in 1924, and 1924 and 1925 were relatively peaceful years. In 1925, however, Britain returned to the Gold Standard at too high a parity, and the need for lowering wages and prices to secure equilibrium in the exchanges began once more to be widely canvassed. Matters came to a head in the coal industry, which was one of the staple export industries which showed no signs of returning to its pre-war level, and was accordingly carrying a great deal of unemployment. The demand of the mineowners that wages should be reduced was rejected by the union. The mineowners then "locked out" the miners, who called on their comrades in other trade unions to come out in sympathy. There was an enthusiastic response. For nine days, from May 4th, 1926, there was virtually a complete strike of manual workers. The leaders of the Trades Union Council, however, urged the miners' leaders to accept a compromise, and when this was rejected, called off the "general strike." The miners held on for six months, but were eventually defeated. The occasion was spectacular, and the temper of the British Labour Movement cannot be appreciated by anyone who has not studied the events leading up to 1926. But the immediate affect on the general level of wages was small; miners' wages

were severely cut, but neither the general level of wages nor the general level of prices was much affected by this dispute.

The movement of real wages was much less spectacular than the movement of money wages. In 1921 prices fell faster than wages and real wages rose (as did also unemployment). Soon, however, money wages were driven down correspondingly. From 1922 real wages increased slightly, reaching in 1929 a level about 9 per cent above that of 1913. This was due to a fall in the cost of living while money wages remained constant.

PRICES

The fall in the price level was one of the notable features of this period. The wholesale price index fell in Great Britain from 160 in 1925 to 134 in 1929; and in the United States from 148 to 138. It is unusual for the price level to be falling during a boom of such magnitude as was occurring in the United States, and the fact that prices were falling helped at the time to conceal the magnitude of the expansion that was occurring. The basic reason for the fall of prices was the great increase in productivity; prices would have fallen even more in the United States but for the fact that money wages were rising—from 217 in 1921 to 237 in 1929 (hourly wages).

Also specially notable was the downward trend in agricultural prices. Some prices were in fact very buoyant, especially those of raw materials and of animal products. Wheat and sugar were the two which were declining most markedly, and the countries in which these commodities were important became increasingly anxious as the twenties drew to a close. The indices for the U.S.A.[7] (1909–14=100) show the general position:

	1925	1926	1927	1928	1929
Prices paid by Farmers	156	155	153	155	154
Prices received by Farmers	156	146	142	151	149
Prices of Food Grains	171	152	135	128	116

It will be observed that while prices paid by farmers moves down very little, prices received by farmers falls more, and the fall in prices of food grains is spectacular. In the United States the agricultural economy is variegated, and as the general index of prices received shows, the fall in the price of wheat was offset by an increase of other agricultural prices. But in countries where wheat is

more dominant, as for instance in Germany, the whole of this period is regarded as one of growing agricultural crisis.

Both wheat and sugar suffered from the same processes. First, during the war output contracted in Europe and expanded overseas, especially in the American continent. The overseas acreage of wheat and of sugar continued to expand after the war, while European production was climbing back to its pre-war level. By 1925 European production had been restored, while the overseas acreage was greatly in excess of the pre-war level. And secondly there was an increase in yield per acre, and a reduction of costs; in wheat due to breeding and the wide adoption of mechanical methods, and in sugar due also to new breeds and to improved methods of extraction. Production outran consumption, and stocks increased steadily throughout the second half of the twenties, with depressing effects on prices.

Many people attributed the world depression, when it came, to effects of the agricultural overproduction. Farmers, they argued, had less to spend and so industrial producers received less; they therefore bought still less from farmers, and depression proceeded in a spiral. This view is unacceptable. In the first place, while the fall in prices gave farmers smaller incomes, it left consumers with more free cash in their pockets, and there is no evidence to suggest that they did not spend on other things what they saved on agricultural products. And secondly, the slump started in the United States; but there on the average the prices received by farmers did not fall very much in comparison with their payments, and if their incomes were smaller, bearing in mind the increase in production, they cannot really have been so much smaller as to create a slump. The relevance of falling agricultural prices was not in initiating the slump but in aggravating it when it came. When once the slump had started, the collapse of agricultural prices, the insolvency of rural banks and the burden of rural debt all proved to be highly deflationary factors.

THE INTERNATIONAL ECONOMY

Thoughts of a major slump were however far from people's minds. The international economy seemed to have settled down. Currencies were stabilised, trade was growing, and there was a large flow of international investment.

Great Britain's return to the Gold Standard in 1925 signalised

the re-establishment of stable exchanges; there were still a few countries to comply, but they came in one by one, the most important late comers being (*de facto*) France in 1926, Belgium in 1927, and Italy in 1928. The new Gold Standard, however was different from the old in that a large number of countries held as reserves foreign exchange in place of or in addition to gold. This increased the importance of London and of New York, the two centres in which most of the foreign exchange reserves were held; at the same time it increased these two countries' need to hold gold, which they needed now not only for their own purposes but also as cover for other countries' reserves. London, unfortunately, was not equal to this strain. For reasons we have already examined her own international exchange position was weak; she was having difficulty in preventing an outflow of gold, and was not able to acquire sufficient gold to hold in reserve. This was to have drastic consequences later when a temporary loss of confidence in London caused foreign creditors to withdraw their reserves, demanding gold in payment, and reduced the gold stocks in London so severely that Great Britain was forced to abandon the Gold Standard.

There was yet another source of weakness in the new "Gold Exchange" Standard, as it was called. A number of the countries which returned to it acquired their reserves of gold or foreign exchange not by means of an export surplus, or of long term borrowing, but through short-term loans. This made their position precarious, for if a loss of confidence initiated a withdrawal of these short-term loans, they would be denuded of reserves and unable to remain on the standard. The fact that the new standard was so vulnerable made it in fact an unsuitable monetary mechanism. Its ultimate collapse was destined to add greatly to the deflationary forces.

In a situation so unstable as this, movements of French balances which occurred were unhelpful. During the French crisis from 1924 to 1926 the French people exported capital, by the process of selling abroad more than they bought and holding the difference in foreign exchange. After the stabilisation they sold their foreign exchange to the banks, and thus the Bank of France acquired considerable foreign holdings. In 1928 the Bank of France decided to convert these holdings into gold. There followed a drain of gold from other countries to France, which was aggravated by the

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undervaluation of the franc giving rise to an export surplus which also was paid for in gold. The gold reserves of the Bank of France increased (in equivalent) from 954 million U.S. dollars at the end of 1927 to 1,633 million at the end of 1929 and 3,257 million at the end of 1932. This put an extra strain on all debtor countries, and was one of the factors that eventually caused the system to collapse.

The instability of the Gold Exchange Standard was not however realised at the time. There was more anxiety about the continued growth of obstacles to international trade. International conferences at Brussels in 1920, at Portorose in 1921 and at Genoa in 1922 had all recommended in favour of reducing these obstacles, but in the atmosphere of falling prices produced by the slump of 1920 they had met with no response. By 1925, however, the atmosphere had improved sufficiently for it to be felt that new preparations should be made for international conferences on trade restriction. A League of Nations calculation[8] (Table V) showed how tariffs had grown since 1913.

TABLE V

AVERAGE TARIFF LEVELS, 1913 AND 1925

	1913 %	1925 %	Increase %
Spain	33	44	11
U.S.A.	33	29	−4
Argentine	26	26	0
Australia	17	25	8
Hungary	18	23	5
Czechoslovakia	18	19	1
Italy	17	17	0
Canada	18	16	−2
India	4	14	10
Sweden	16	13	−3
Austria	18	12	−6
France	18	12	−6
Germany	12	12	0
Switzerland	7	11	4
Belgium	6	8	2
Denmark	9	6	−3
Netherlands	3	4	1
U.K.	0	4	4

Two conferences were held at Geneva in 1927. The first dealt with absolute prohibitions on trade, and the second with tariffs. From the first (and subsequent conferences on this subject) emerged a

convention agreeing to abolish all absolute prohibitions, which nearly secured enough ratifications to come into force, but which failed owing to German and Polish reservations. The second produced recommendations in favour of tariff reductions. It was followed by some months during which the flow of tariff increases was greatly curtailed, and there was also some reduction of tariffs. Hopes, however, diminished as news of proposed tariff increases in America began to crystallise, from the end of 1928; and the onset of the slump in 1929, followed by the American "biggest ever" Hawley-Smoot tariff in 1930, made agreement impossible. Tariff increases after 1929 were bigger than ever.

The increase of world trade between 1925 and 1929 was assisted by the maintenance of a high level of foreign investment. The following estimates[9] for 1928 show the principal lenders and borrowers:

Lenders	$000,000	*Borrowers*	$000,000
U.S.A.	1,099	Germany	1,007
U.K.	569	Australia	193
France	237	Argentine	181
Czechoslovakia	61	Canada	164
		Poland	124

The supreme importance of the United States as a lender stands out and so does the predominance of Germany as a borrower. In relation to world trade as a whole the total sums involved in foreign investment were small, in the neighbourhood of 6 per cent, but they were large elements in the economies of the countries specially involved, and as these were important countries, the importance of capital movements in the flow of trade was greater than this figure indicates.

The methods of financing foreign investment caused some disquiet. A large proportion, as we have already seen, was short term lending and its volatility was liable to do mischief. But even the long term lending was not well proportioned as between fixed interest loans and equities, and between government bonds and industrials. Thus in the year 1928 American long term investment[10] was divided as follows: Government and municipal loans 45 per cent, industrial bonds and notes 47 per cent, preference shares 3 per cent, and ordinary shares 5 per cent. A good deal of the money lent to governments was just wasted; and in any case even where the money was well used, it imposed a fixed interest

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payment without always adding even indirectly to the exportable surplus from which this payment could be made. The low proportion of equities also meant that, as trade diminished, fixed interest payments would absorb a constantly increasing proportion of the disposable surplus. So long as the upward movement continued, all was well; but as soon as conditions began to deteriorate, weak policies would stand revealed. The fact that New York had not adequate machinery for foreign lending was also unfortunate. There were no specialised houses with a long tradition; the cost of issues was very high; and the investing public fickle, shifting its interest too easily between foreign and domestic capital issues. This added to instability; the suddenness with which the flow of foreign loans contracted did much eventually to increase the difficulties of overseas countries.

CONCLUSION

It is easier now to assess the second half of the twenties than it was at the time. The current view was dominated by rising prosperity, so largely associated with American expansion and American lending. The war and its strains were being forgotten. But we can see now that if 1919–25 was a period obviously dominated by the effects of the war, 1925–1929 was just as much a period of readjustment to the effects of the war, though these effects were no longer visible on the surface. Problems left by the war remained unsolved, especially the creation of a stable international currency system, the adjustment of the size of the agricultural economy, and the reorientation of Britain, of Germany and of France in the post-war world. So soon as America ceased to expand and to lend, then underlying maladjustments were to come out and to take charge.

CHAPTER IV

1929–1939

COLLAPSE

SUCH had been the expansion of prosperity in the United States since 1922 that many people had come to believe that the country had found the secret of permanent prosperity, and would never again be submerged in depression. This, however, was not the opinion of economists, nor of the monetary and other authorities. On the contrary they were expecting a slump sooner and were surprised that it was so long delayed.[1]

The reason for this expectation was that the country was recognised to be in the grip of a speculative fever, which could not last. After a slight recession in 1926, the prices of stock exchange securities had begun to rise, and this rise had continued with accelerating speed to levels out of all relation to real values. The index[2] had risen from 100 in 1926 to 216 in September 1929. The boom was based not primarily on an increase in profits, but rather on a process which can only be described as "a dog chasing its own tail": since prices were rising it was profitable to buy to resell, irrespective of the yield of the securities, and even of whether they were paying any dividends or not; all sorts of persons who knew very little about securities were drawn into the market, and prices soared gaily upwards.

The monetary authorities knew that this process could not last and that if prices rose too far the shock of their collapse would surely damage the economy. From the beginning of 1928 they tried to check the boom, by trying to restrict the sums available for stock exchange speculation, but they were unsuccessful. They resigned themselves therefore to an inevitable collapse. Indeed in many quarters the collapse was eagerly awaited, since it was expected to bring prices back into reasonable relation with each other, and so to strengthen the economy.