The Economic Meltdown

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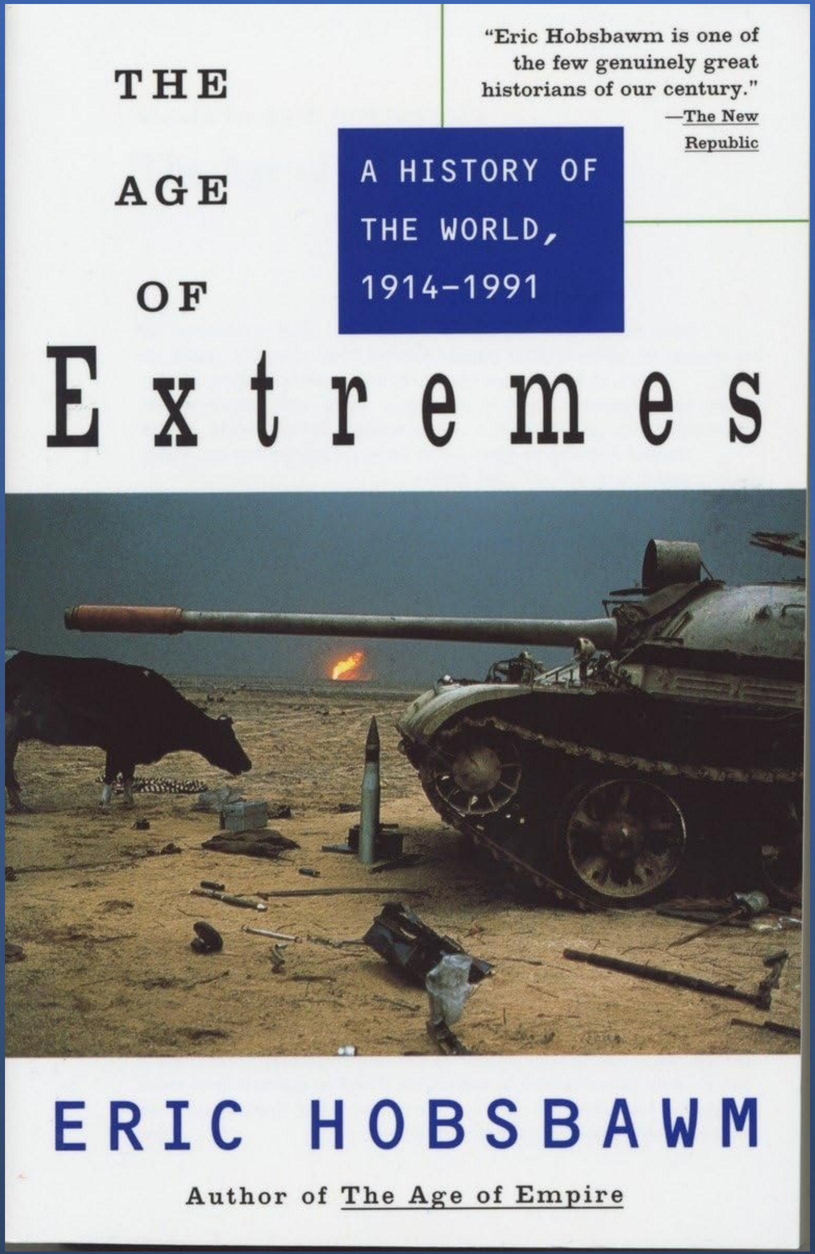
Aftermath of the Great War

- The Treaty of Versailles 1919 ended the Great War and created the League of Nations to foreclose the possibility of another war.
- The unpredictable future defied the expectations of the signatories of the Treaty of Versailles in multiple ways.
- The peace terms and the League of Nations failed to forbid another, yet more destructive and widespread war. We will discuss the factors that led mankind there in these two weeks consecutively.
- Today, we will talk about another unforeseen impact of the Great War on the lives of millions of human beings during the interwar period with the slowing down and convulsions of the world economy and finally the economic meltdown and the depression of 1929-1939.

Economic Meltdown

- We will do it in two parts. We will see how it affected the world, beginning with the most challenged economy of Germany and then specifically the United States.
- The War Guilt clause in the Treaty of Versailles held Germany responsible for the Great War and imposed excessively punitive and crippling penalties on the defeated leaders of the Central Powers.
- Economics is hard to get. I will rely on a source that I like. British historian Eric Hobsbawm covered it in detail in Chapter Three, Into the Economic Abyss (pp 85-108), in *The Age of Extremes*, 1994. All details come from Hobsbawm.


THE AGE OF Extremes
"Eric Hobsbawm is one of the few genuinely great historians of our century." —The New Republic
A HISTORY OF THE WORLD, 1914–1991
ERIC HOBSBAWM
Author of The Age of Empire

The War and the Economic Meltdown

- Hobsbawm distinguishes between the impact of the Great War and the economic meltdown. The Great War, he explains, had global reverberations but it did leave part of the world untouched. The war was "followed by one kind of breakdown that was genuinely worldwide at least wherever men and women were enmeshed in or operated by impersonal market transactions. Indeed, the proud USA itself, so far from being a safe haven from the convulsions of less fortunate continents, became the epicenter of this, the largest global earthquake ever to be measured on the economic historians' Richter scale-- the Great Interwar Depression. In a sentence: between the wars the capitalist world economy appeared to collapse. Nobody quite knew how it might recover," (Hobsbawm, 86).

A Different Crisis

- The capitalist economy was familiar with the fluctuations and trade cycles of boom and slump. The economic breakdown was, however, a different crisis. Hobsbawm says, “What was novel about the new situation was that, probably for the first, and so far the only, time in the history of capitalism, its fluctuations seemed to be genuinely system-endangering. What is more, in important respects the secular rise of its curve seemed to break,” (Hobsbawm, 87).

The Facts

- Here are some of the facts that stand out:
  - Contrary to an accelerating global, though uneven, economic growth since the Industrial Revolution, the world economy on average slowed down beginning in 1913. The economic growth did not cease but declined.
  - The world industrial production grew by just over 80% in the twenty-five years after 1913 or at about half the rate of the previous quarter century.

Global Migration

- There was a net decline in the integration of the world economy. Mass migration stagnated or regressed.
- Fifteen million people had migrated to the United States in the fifteen years before 1914. In the next fifteen years, the flow shrunk to five and a half million. Less than three-quarters of a million entered the USA in the 1930s and during the war years.
- Iberian migration overwhelmingly to Latin America fell from one and three-quarter million (1,750,000) in the decade 1911 to 1920 to less than a quarter of a million in the 1930s.

Global Trade

- World Trade declined and in 1948 was not significantly higher in volume than before the First World War. Between the early 1890s and 1913, it had more than doubled. Between 1948 and 1971, it would quintuple.
- The World Trade fell by 60% in four years of the Great Depression from 1929 to 1932. The prices of primary production items, such as foodstuffs and raw materials, dropped massively. The price of wheat and tea fell by two-thirds, and the price of raw silk by three-quarters. Major producers of coffee, Brazilian farmers burnt coffee instead of coal in their steam railroad engines.
- Thus, the Depression was a global phenomenon. We can assess it from the League of Nations' 1931 list of countries affected because of their dependence on the export of just a few commodities. It included Argentina, Australia, the Balkan countries, Bolivia, Brazil, British Malaya, Canada, Chile, Colombia, Cuba, Egypt, Ecuador, Finland, Hungary, British India, Mexico, the Netherlands, Indies, i.e., the present Indonesia, New Zealand, Paraguay, Peru, Uruguay, and Venezuela.

Global Trade

- The crisis also affected the economies of Austria, Czechoslovakia, Greece, Japan, Poland, and Great Britain because they relied on international trade.
- The United States imported ninety percent of the Japanese silk. The industry had tripled its output in 15 years, making silk stockings. This market disappeared.
- The price of Japanese rice as well as of other producers in South and East Asia plummeted affecting farmers in rice exporting countries of Burma (Myanmar), French Indochina, and Siam.

Global Trade

- At a time when international trade slumped, states found themselves building increasingly high barriers to protect their national markets and currencies.
- The most favored nation status disappeared from almost 60% of 510 commercial agreements signed between 1931 and 1939.
- Britain abandoned free trade principles in 1931.

International Lending

- Germany was affected by the dearth of credit in the international market. It had borrowed about half of all the world's capital exports. In 1928, Germany borrowed between 20,000 and 30,000 billion marks. When the American money stopped in 1929, it exposed the vulnerability of the German economy.
- Post-war Europe, beginning with Germany, depended on US credit. The German economy had not recovered from the war effect but had to make reparation payments on time. The US loans bailed them out.
- Beginning in 1928, American investors sought to maximize the advantage at home from the soaring unregulated stock market. They began pulling their money out of the German loan market and also demanded repayment of loans.

International Lending

- Reparations were thus closely linked to international lending.
- The Versailles Peace Conference in 1919 imposed vast but undefined payments on Germany. In 1921, the sum was fixed at 132 billion (thousand million) Gold Marks, about $33 billion at the time.
- The sums demanded of the Germans amounted to one and a half times the entire national income of the country in 1929.
- The German reparations went through several adjustments in the years to come. In 1924, the Dawes Plan fixed a real sum for Germany to pay annually. In 1929, a Young Plan modified the repayment scheme. It also set up the Bank of International Settlements in Basel, Switzerland, the first of the international financial institutions.
- For practical purposes, all payments German and Allied, ceased in 1932.

International Lending

- John Maynard Keynes argued that without a restoration of the German economy, the restoration of a stable liberal civilization and economy in Europe would be impossible.
- The French policy of keeping Germany feeble for the sake of French security was counterproductive. They had required payments in cash which forced Germany into heavy borrowing. It means that such reparations as were paid came out of the massive American loans.
- Germany, like Europe, was highly sensitive to the decline in American lending which began even before the crisis. The loan tab shut off after the Wall Street crisis of 1929. The entire House of Cards of Reparations collapsed during the slump.
- The collapse reinforced American thinking post-1945 to take greater responsibility for the stability of the world economy.

International Lending

- The Europeans, besides Germany, also owed large debts to the United States: the British equal to half the British national income, the French 2/3rd.
- The Europeans linked their repayments to the United States to German reparations: Germany pays me, I will pay you. Germany borrowed from the US, paid reparations due, and receiving countries paid part of their debts to the United States.
- Hitler reneged on German reparations in 1933.

Monetary System

- Many European states, including Germany, experienced a drastic collapse of the monetary system. German currency unit was reduced in 1923 to “one million millionth of its 1913 value,” (Hobsbawm, 89).
- Private savings disappeared totally, creating an almost complete vacuum of working capital.
- The traumatic effect of the experience on the local middle and lower middle classes may be imagined. It made central Europe ready for fascism.

Monetary System

- From 1931 to 1932, Britain, Canada, all of Scandinavia, and the USA abandoned the gold standard always regarded as the foundation of stable international exchanges.
- By 1936, the Belgians, Dutch, and the French also joined the list.

Industrial Production

- The Stock Exchange crash of 1929 resulted in the decline of industrial production worldwide.
- US industrial production fell by about 1/3 from 1929 to 1931. German production by about the same.
- The recession massively hurt major US companies. The Westinghouse lost 2/3rd of its sales between 1929 and 1933 while its net income fell by 76% in two years.

Unemployment

- Unemployment remained on the rise even during the boom period between 1924 and 1929. It averaged between 10 and 12% in Britain, Germany, and Sweden, and no less than 17 to 18% in Denmark and Norway. Only the USA had a low unemployment of about 4%.
- In the worst year of the slump 1932-33, it skyrocketed: Britain and Belgium 22-23%, Sweden 24%, the US 27%, Austria 29%, Norway 31%, Denmark 32%, Germany 44%, or more. Up to 85 % of the membership of the German Communist Party in 1932-33 comprised unemployed persons.
- During the recovery after 1933, the average unemployment reduced but not below 16 to 17% in Britain and Sweden, 20% in the rest of Scandinavia, Austria, and the US.
- The only Western state which succeeded in eliminating unemployment was Nazi Germany between 1933 and 1938.

Unemployment

- Unemployment hit the labor hard as there were only a few welfare states before the Second World War. The Scandinavian countries had just begun to develop it.

The Exception: A Challenge

- The Soviet Union, not only evaded the collapse but realized ultra-rapid industrialization.
- During its five-year plans from 1929 to 1940, Soviet industrial production tripled. It rose from 5% of the world's manufactured products in 1929 to 18% in 1938. During the same period, the joint share of the USA, Britain, and France fell from 59% to 52% of the world's total.
- Also, the USSR had no unemployment.
- The idea of planning gained respect in the West.

Profound Effect of the Economic Breakdown

- “But for it, there would certainly have been no Hitler. There almost certainly have been no Roosevelt. It is extremely unlikely that the Soviet system would have been regarded as a serious economic rival and alternative to world capitalism,” (Hobsbawm, 86).

Focus on America: Unpredictable Future

- This is how President Calvin Coolidge articulated the State of the Union on December 4, 1928:

No Congress of the United States ever assembled, on surveying the state of the Union, has met with a more pleasing prospect than that which appears at the present time. In the domestic field there is tranquility and contentment, harmonious relations between management and wage earner, freedom from industrial strife, and the highest record of years of prosperity. In the foreign field there is peace, the good will which comes from mutual understanding, and the knowledge that the problems which a short time ago appeared so ominous are yielding to the touch of manifest friendship. The great wealth created by our enterprise and industry, and saved by our economy, has had the widest distribution among our own people, and has gone out in a steady stream to serve the charity and the business of the world. The requirements of existence have passed beyond the standard of necessity into the region of luxury. Enlarging production is consumed by an increasing demand at home and an expanding commerce abroad. The country can regard the present with satisfaction and anticipate the future with optimism.

America and the Great War

- The Great War benefited America spectacularly. By 1913, the USA had already become the largest economy in the world, producing over 1/3 of its industrial output, just under the combined total for Germany, Great Britain, and France. In 1929, it produced over 42% of the total world output as against just under 28% for the three European industrial powers.
- The US steel production rose by about 1/4 between 1913 and 1920, while steel production in the rest of the world fell by about 1/3.

The Spread

- After the end of the Great War, the US was the world's greatest industrial producer and the greatest creditor. During the war, the British had lost about 1/4 of their global investments, the French about half of theirs.
- America had begun the war as a debtor country but ended it as the main international lender.
- America also imported almost 40% of all the raw materials and foodstuffs of the 15 most commercial nations, having an enormous impact on the producers of commodities like wheat, cotton, sugar, rubber, silk, copper, tin, and coffee.
- During the slump, while its imports fell by 70% between 1929 and 1932, its exports fell at the same rate. World Trade dipped by less than 1/3 from 1929 to 1939 but US exports crashed by almost half.

Economic Meltdown

- The economic meltdown hit the New York stock market in October 1929.
- The credit crunch hit the western banking sector. Within two years, thousands of banks and businesses failed.
- The crisis affected all major economic indicators such as spending, industrial and agricultural production, employment, and consumer confidence.

Economic Meltdown: Focus on the United States

- Between October 24-29, 1929, the stocks kept tumbling despite substantial efforts by leading bankers to stabilize the prices. On Black Tuesday, the shares of U.S. Steel dropped from $ 262 to $ 22, GM from $ 73 to $ 8 and Rockefeller lost four-fifths of his fortune.
- Only 2.5 percent of Americans had brokerage accounts then. Financial panic was, therefore, one of the many factors of the slump which included rising inequality, declining demand, rural collapse, overextended investors, and the bursting of speculative bubbles.

Economic Meltdown: Focus on the United States

- The American prosperity since 1924 had been unequally distributed. By 1929, American per capita incomes had risen but with a huge gap: ten percent on average but 75 percent for the nation’s wealthiest citizens.
- The pro-business policies of the 1920s offered low corporate and personal taxes, easy credit, and depressed interest rates that overwhelmingly favored wealthy investors and speculators.

Economic Meltdown: Focus on the United States

- While manufacturing capacity increased in the 1920s, the purchasing power of the consumers needed to catch up with it. By the end of 1929, new car registrations dropped by almost a quarter, and consumer spending on durable goods dropped by a fifth in 1930.
- Unemployment, which hovered around seven percent during the 1920s touched 25 percent in 1932. Black unemployment reached as high as 50 – percent while Black workers also faced wage cuts.
- Women, single or married, and nonwhite Americans were more likely to lose jobs.
- "Hoovervilles," spontaneous shantytowns that dotted America's cities, became homes of the most desperate, chronically unemployed Americans, who encamped on public or marginal lands and depended on bread lines and street-corner peddling.

Economic Meltdown: Focus on the United States

- Economic crisis battered the agricultural sector years before the Black Tuesday. The massive war year profits slumped in 1920-21. The production climbed as domestic and international demand for cotton, foodstuffs, and other agricultural products stalled.
- The Dust Bowl states, the Great Plains from Texas to the Dakotas suffered the most as severe droughts hit them between 1932-36.
- Displaced farmers joined millions of persons moving around the country. Thousands of them migrated out of the Dust Bowl areas. Oklahoma lost 440,000 people, or a full 18.4 percent of its 1930 population, to outmigration.

DUST STORM DAMAGE, 1930-1940

Economic Meltdown: Focus on the United States

- California was a favorite destination for the displaced farmers but the receiving states like California, Florida, and Colorado turned hostile to the poor migrants. In 1935-36, these states established ”border blockades,” to discourage inflows.
- Barriers went up also for immigrant labor in 1930 as the Hoover administration pursued restrictive policies. The number of European visas issued fell by roughly 60 percent. Between 1930 and 1932, fifty-four thousand people were deported. An additional forty-four thousand deportable aliens departed “voluntarily.” Citizens in Los Angeles joined the law enforcement officials to deport Mexicans. From 1930 to 1940, the Mexican-born population living in Arizona, California, New Mexico, and Texas fell from 616,998 to 377,433.

Economic Meltdown: Focus on the United States

- The crisis affected war veterans as well. More than fifteen thousand of them, a Bonus Expeditionary Force, built a “Hooverville,” in Washington D.C., in 1932 pressing for a bill authorizing immediate payment of cash bonuses to veterans of World War I that were originally scheduled to be paid out in 1945.
- Hoover called them “insurrectionists.” General Douglas MacArthur led a heavily armed operation to evict them from the federal capital and torched the shantytown.

Searching for Solutions

- The governments' responses took shape in two phases. Initially, they resorted to the old methods of resolving an economic crisis. Later, they took an innovative approach.
- The old way: the government attempted to balance the budgets and increased tariffs on imports.
- Instead of resolving the problem, the old methods worsened the situation, dampened spending, and hindered trade.

Searching for Solutions:
Focus on the United States

- Preferring the old methods of coping with economic crises, the Hoover administration enforced the highest tariff in American history, the Smoot-Hawley Tariff of 1930.
- Other countries responded in kind, hurting the international trade. Between 1929 and 1932, international trade dropped from $36 billion to only $12 billion.
- American exports in the same period fell by 78 percent.
- Combined with overproduction and declining domestic consumption, the tariffs exacerbated the world's economic collapse

Searching for Solutions:
Focus on the United States

- Besides the tariffs, the Federal Reserve raised the interest rates to combat speculation. The Fed policy tightened credit. Across the country, banks denied loans and called in debts.
- Black Tuesday spurred financial panic which resulted in massive bank runs. The banks collapsed in thousands, 1352 in 1930 and 2300 in 1932, depriving consumers of their personal deposits, savings, and credit.

Searching for Solutions: Focus on the United States

- Facing public outrage, the Hoover administration remained reluctant to take direct action as it would have contravened the principle of limited government.
- The President encouraged voluntary action, and *associationalism*, emphasizing voluntary organizations to rescue their fellow citizens in times of need. The private charities stepped in but had insufficient capacity to mediate the crisis.
- In 1932, Hoover created the Reconstruction Finance Corporation (RFC) to provide emergency loans to banks, building-and-loan societies, railroads, and other private industries. It bypassed needy Americans. New York congressman Fiorello LaGuardia denounced the RFC as a “millionaire’s dole.”

Searching for Solutions:
Focus on the United States

- The crisis took a turn toward possible exit with the consequential election of 1932. Hoover warned the country that a plan based on public work projects, higher wages, shorter hours, old-age pensions, unemployment insurance, farm subsidies, banking regulations, and lower tariffs meant a total abandonment of the American system.
- Crisis-ridden Americans liked what Franklin Delano Roosevelt proposed and believed in his July 1932 affirmation, “I pledge you, I pledge myself, to a new deal for the American people.” They voted for him in four consecutive Presidential elections and the New Deal opened the road to the end of the economic crisis.

Searching for Solutions: Focus on the United States

- Roosevelt mobilized the nation against the crisis, beginning with his inaugural address,

> "This great Nation will endure as it has endured, will revive, and will prosper. So, first of all, let me assert my firm belief that the only thing we have to fear is fear itself—nameless, unreasoning, unjustified terror which paralyzes needed efforts to convert retreat into advance."

March 4, 1933

Searching for Solutions: Focus on the United States

- FDR’s New Deal faced constitutional and judicial hurdles but in essence, steered the country towards a solution. Some of the major reforms included:
- Restoration of confidence in the banking system.
- The Civilian Conservation Corps (CCC) employed young men on conservation and reforestation projects.
- The Federal Emergency Relief Administration (FERA) provided direct cash assistance to state relief agencies struggling to care for the unemployed.
- The Tennessee Valley Authority (TVA) built a series of hydroelectric dams along the Tennessee River as part of a comprehensive program to economically develop a chronically depressed region.
- Several agencies helped home and farm owners refinance their mortgages.

Searching for Solutions:
Focus on the United States

- The Agricultural Adjustment Administration (AAA) and the National Recovery Administration (NRA). In 1935, the Supreme Court declared the NRA unconstitutional. In early 1936, the AAA fell.
- The AAA, created in May 1933, aimed to raise the prices of agricultural commodities (and hence farmers' income) by offering cash incentives to voluntarily limit farm production (decreasing supply, thereby raising prices).
- The National Industrial Recovery Act (NIRA), which created the NRA in June 1933, suspended antitrust laws to allow businesses to establish "codes" that would coordinate prices, regulate production levels, and establish conditions of employment to curtail "cutthroat competition." In exchange for these exemptions, businesses agreed to provide reasonable wages and hours, end child labor, and allow workers the right to unionize.

Searching for Solutions: Focus on the United States

- The Civil Works Administration (CWA) and, later, the Works Progress Administration (WPA) put unemployed men and women to work on projects designed and proposed by local governments.
- The Public Works Administration (PWA) provided grants-in-aid to local governments for large infrastructure projects, such as bridges, tunnels, schoolhouses, libraries, and America’s first federal public housing projects.

Searching for Solutions:
Focus on the United States

- 1938 Fair Labor Standards Act, set a national minimum wage of \$0.25/hour (eventually rising to \$0.40/hour). The minimum wage disproportionately affected low-paid southern workers and brought southern wages within the reach of northern wages.
- The 1935 National Labor Relations Act, also known as the Wagner Act, guaranteed the rights of most workers to unionize and bargain collectively.
- In 1935, he established the Works Progress Administration (WPA), a permanent version of the CWA, which would ultimately employ millions of Americans on public works projects.

Searching for Solutions: Focus on the United States

- Restored a highly progressive federal income tax,
- Mandated new reporting requirements for publicly traded companies,
- Refinanced long-term home mortgages for struggling homeowners and attempted rural reconstruction projects to bring farm incomes in line with urban ones.
- The Social Security Act of 1935 provided for old-age pensions, unemployment insurance, and economic aid, based on means, to assist both the elderly and dependent children.

Searching for Solutions--Imperialism

- The imperial powers also turned toward their colonial empires for secure trade and profits. Unintended, awareness of this interdependence spurred the independence movements in India, Iraq, Vietnam, Algeria, and elsewhere.

Searching for Solutions—New Ways

- The governments began to agree with John Maynard Keynes (1883-1946) who argued for more governmental expenditures and growing budgetary deficits to stimulate consumer spending and raise employment.
- The Scandinavian democracies were the first to move along that path for a positive uptick.
- After 1932, the governments of the United States, Britain, and Germany followed suit to initiate the slow process of recovery.

Conclusion

- Wars have unforeseen consequences. The peace terms in this case contributed to a worldwide economic crisis and enabled the emergence of fascism which we will discuss in our next lecture.
- The States act in their interests, the way they understand them in the moment they make decisions. The interest was to ensure peace and weaken an enemy. German economy suffered under the crushing burden of reparations. The requirement for cash payments generated the need for loans that dried up and crashed the repayment system.
- The US faced a challenge to recover from the Great Depression. FDR began the process, but full recovery will have to wait for another war.