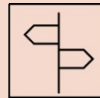


ECONOMIC AND BUSINESS HISTORY 22/23

LECTURE 14: SOLVING THE GD



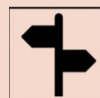
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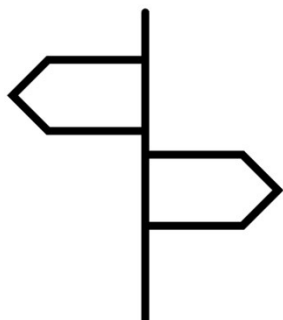
1. Pre-GD Policy



2. Interventionism



3. New Policies



1. Pre-GD Policies

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Liberal Policies (pre-1930s)

- Crises seen as temporary, as the market was trusted to lead to U-shaped automatic recoveries
- Trust in market and price mechanisms:
 - Changes in prices expected to correct excess production or scarcity, with no need for state policies and incentives
- When in Crisis, the role of the State was twofold:
 - Keep balanced state budgets (deficit zero)
 - Provide monetary stability (typically, keeping the country in the gold standard)
- Thus, investors and businesses could regain confidence to find the new 'smart' investments and growth would resume

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Yet, ...

- In the eyes of the contemporaries, liberal policies proved unable to deal with the GD
- Instead of a U-shaped recovery, a series of deep recessions in 1930-33 unfolded
- Unemployment surged, as there was no investment
- A major problem was that the FED kept Interest Rates too high to stimulate investment and employment

Year	GDP growth
1928	1,1
1929	6,1
1930	-8,9
1931	-7,7
1932	-1,3
1933	-2,1

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Yet, ...

- As the economy contracted, unemployment surged,
- As there was little investment, with the low expectations of consumers, redundant workers had trouble in finding new jobs.

Year	GDP growth	Unemployment rate
1928	1,1	4,4
1929	6,1	3,2
1930	-8,9	8,7
1931	-7,7	15,9
1932	-1,3	23,6
1933	-2,1	24,9

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Yet, ...

- As employment fell, so did prices
- Yet, despite drop in prices, low-expectations consumers limited their purchases of durable and non-essential goods
- This meant five years of deflation

Year	GDP growth	Unemployment rate	Inflation Rates	FED Interest Rates (Discount Rates)
1928	1,1	4,4	-1,2	4,2
1929	6,1	3,2	0,0	4,8
1930	-8,9	8,7	-2,7	3,9
1931	-7,7	15,9	-8,9	2,9
1932	-1,3	23,6	-10,3	3,5
1933	-2,1	24,9	-5,2	3,8

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Yet, ...

- Facing low unemployment and low investment, the FED should have lowered down interest rates
- However, interest rates too high to stimulate investment & employment
- With high interest rates AND deflation investors were being rewarded with returns on their bank accounts and would not risk investment

Year	GDP growth	Unemployment rate	Inflation Rates	FED Interest Rates (Discount Rates)
1928	1,1	4,4	-1,2	4,2
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With the GD, liberal policies were discredited

- The US public, like everywhere else, started to look for alternatives
- It was well-known that some countries had resisted the GD without the typical liberal policies
- With its central planning system, the URSS, in particular, proved very resilient

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2. Interventionism

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FDR and the ND

Franklin D. Roosevelt was elected by an landslide victory in late 1932 with the (very vague) mandate of “reforming” the economy

He run on the verdict by public opinion that Markets and Capitalism had ‘failed’


Immediately after being, FDR started his *New Deal* (March 1933)

In the words of Keynes, FDR’s “priority was reform not recovery”

That is, ND was about creating a new set of institutions that recovered employment

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New Deal (distant) cousins

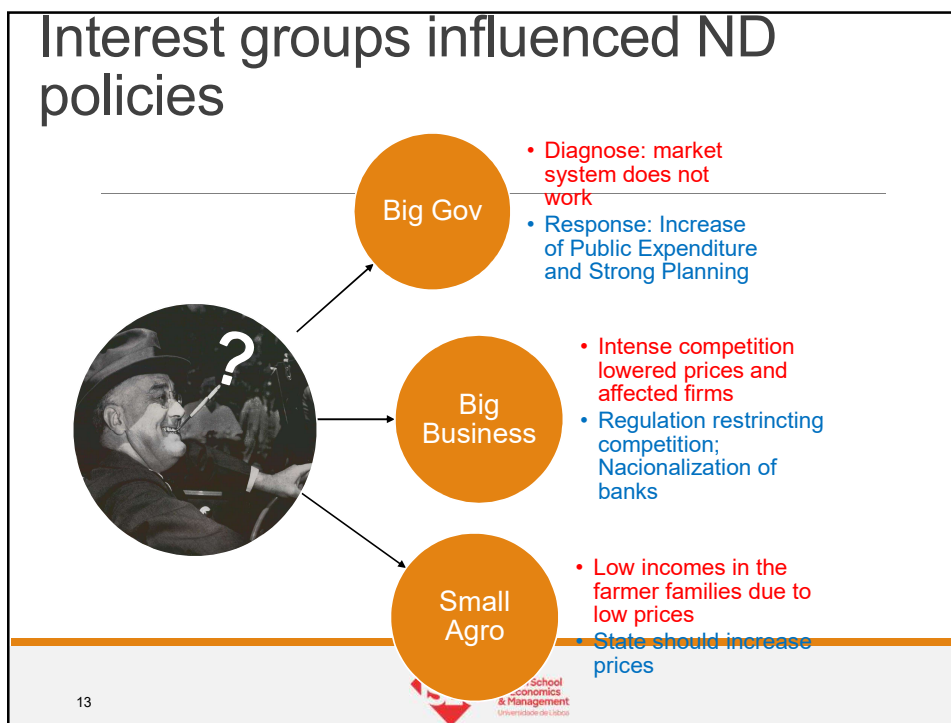


- Capitalismo leads to the struggle between workers and capitalists, weakening nations
- Government should balance these antagonics groups (or ‘corporations’, hence ‘corporativism’)

- Capitalism leads to the oppression of workers by capitalists
- The state should concentrate all factories and capital goods and set the ‘necessay’ level of production

- Capitalism leads to the oppression of the *people*
- States should direct private business according to the interest of the *people*

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Example of New Deal policy: National Industry Recovery Act:

- **Diagnose:**
 - Markets were the problema: competition → excess production → falling prices → unemployment
- **Solution:**
 - Balancing the interests of workers and corporations (like the European "Corporativism")
 - NRA shielded companies from competition (by allowing cartels and trusts to set favourable prices for firms)
 - AS A COMPENSATION, companies protect their workers with minimal wages, better working conditions and unions)
- **Effects:**
 - Law was revoked as unconstitutional
 - Minimal wages and working conditions remained
 - Anyway, it was step in the wrong direction

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A Balance of the ND (pre-1935)

Hundred Ways was about “Reform” not “Recovery” policies

Interest rates charges remained high

Like the NRA, most measures were from the Supply Side

- Industries wanted to increase prices, in exchange for firms keeping jobs
- Likewise, farm prices were higher because of state intervention

And ignored the trouble with Aggregate Demand

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New Deal II

Also, it was fiscally conservative (zero deficit was still the main principle; New expenditures were funded by cuts on charities, pensions and public servants' positions)

From 1935, the budget started to show deficits

- Farmers' subsidies & public works led to increasing expenses
- Little economic recovery led to falling revenues

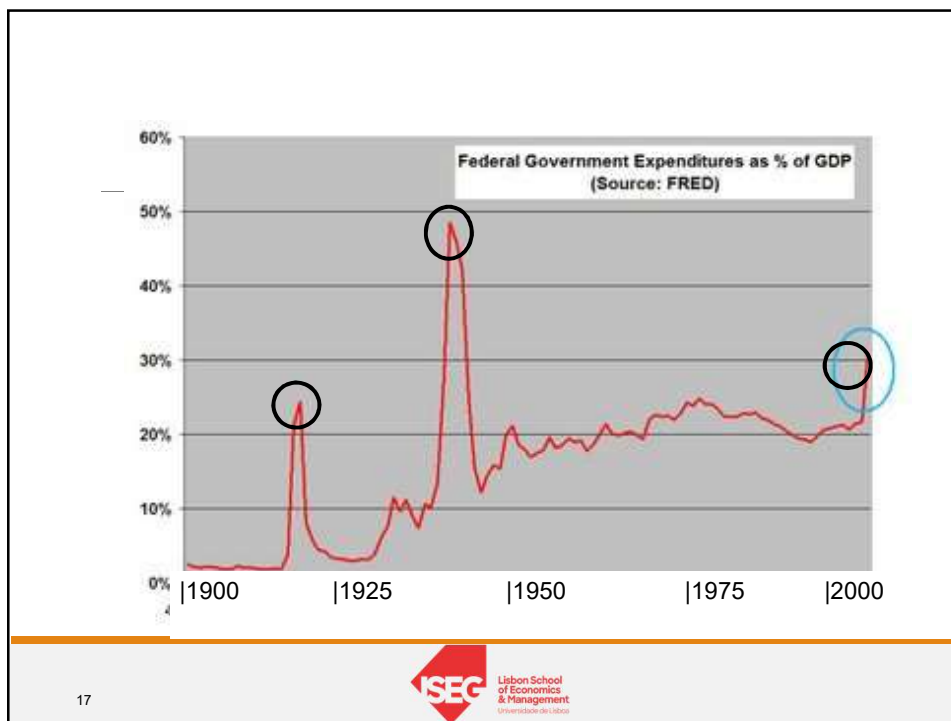
Gov justifies the expenditure as a temporary solution, as a strategy

Yet, not enough jobs were created and recoveries did not last.

Then, WW II came along....



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WWII solved GD

Like with WWI, with WWII, the state mobilized **labour** and **capital**, in a way that markets did not during the 1930s.

War effort absorbed the workforce, either through military service or work in the factories to supply military operations

The war effort also meant that private capital was lent via public debt

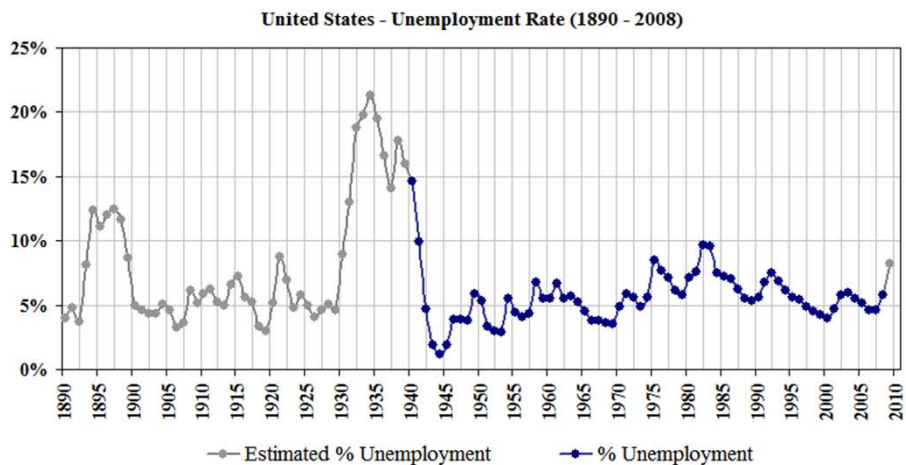
The result of WWII was an abrupt fall in unemployment and a high level of (state) consumption and investment

As Keynes had explained, public expenditure followed different rules from private:

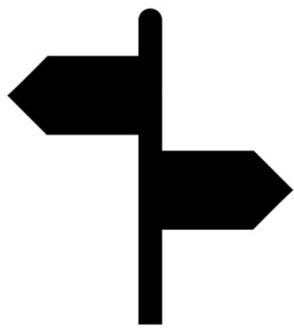
- The state spent without concern for profitability and hence was able indifferent to expectations



Unemployment Rate in the US (1890-2008)



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3. New Policies

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Other new policies

- The 1930s were a period of experimentation of new policies
- While WWII cut these experiments short, they proved very influential in the way economic agents behaved after 1945 (see Text 4)
- Unlike the liberal policies, these alternatives were concerned not only with growth but also with the social impact of growth (especially with unemployment)

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The NAZIs: Guns or Butter?

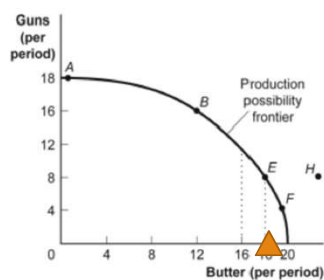
‘We can live without butter, but not without guns, because butter does not fire’
(Goebbels)

‘We have guns, even if we have little butter; What is best? Guns get you prepared, butter makes you fat....’ (Goring)

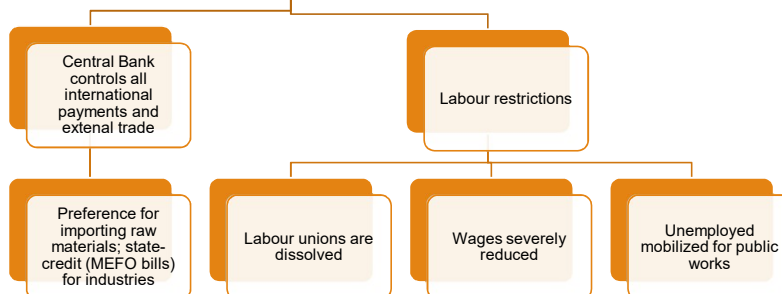


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Figure: Guns and Butter



“Guns, no butter!”



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‘Big Push’ Industrialisation and Central Planning



- ✓ The URSS, after experiences with ‘war communism’ and New Economic Policy (which included some private property in agriculture), propagated the idea that Socialism as an economic system to promote development
- ✓ Need for a ‘Big Push’
 - ✓ Total state ownership of the means of production (factories and agricultural lands)
 - ✓ Output levels decided by central planning.
 - ✓ Priority was given to capital-intensive sectors and in terms of economic growth

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Distribution of the World Industrial Output in 1913, 1926-9 and 1936-8 (%)

	1913	1926-9	1936-8
USA	35,8	42,2	32,3
Germany	14,3	11,6	10,7
GB	14,1	9,4	9,2
France	7,0	6,6	4,5
URSS	4,4*	4,3	18,5
Sweden	1,0	1,0	1,3
Japan	1,2	2,5	3,5
India	1,1	1,2	1,4
Rest	21,1	21,2	18,7

Kenwood e Lougheed 1999: 173.

Social Market Economy and the Welfare State

While Socialism and Nazi economic policies had some short-lived successes, the most successful model was the **“social market economy”**

Born out of interventionism and mixed with socialist-influenced elements, this model combines a new type of state (see below) and a new type of policies (see next slide)

- ✓ Development of social security schemes and free supply of merit public goods such as education and health, creating the so-called *welfare state*
- ✓ Redistribution of income by means of steeply progressive taxation
- ✓ Nationalisation of large companies in sectors of public utilities (e.g. electricity, telecommunications, transportations) to provide public goods at low prices.
- ✓ Some elements of economic planning (incentives for the private sector)

Social Market Economy, Welfare State and New Policy (1)

- Market Economies also innovated in terms of policy
- WWII taught governments to think in 'macroeconomic' terms:
 - With budgets, money and interest rates, governments and central banks had the capacity to influence private business decisions
 - Governments could increase or decrease the propensity to hire and to invest

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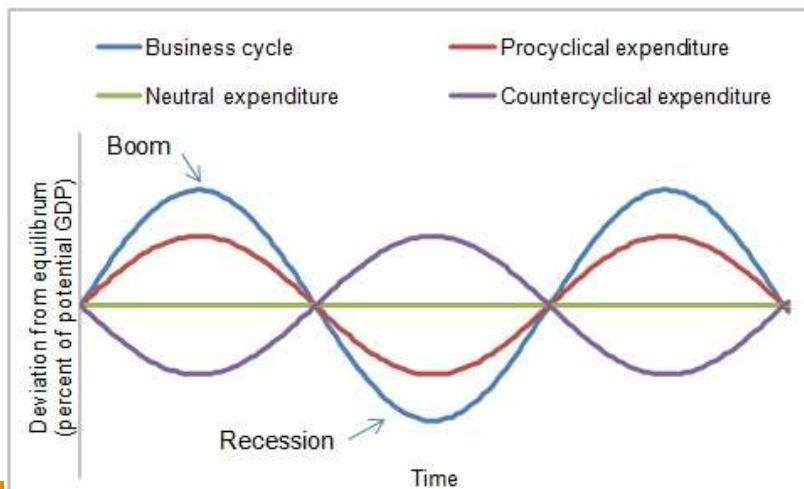
Social Market Economy, Welfare State and New Policy (2)

- Money supply (or interest rates), budgets and taxes became tools for governments to attain their goals
- Among these goals, full-employment was the priority (even more important than growth)
- Thus, from the 1940s to the 1970s a set of coherent policies was designed
 - Public Expenditure
 - Monetary
 - Fiscal
- This powerful toolbox was designed to keep full-employment of labour and capital, without replacing the market with a strong public sector

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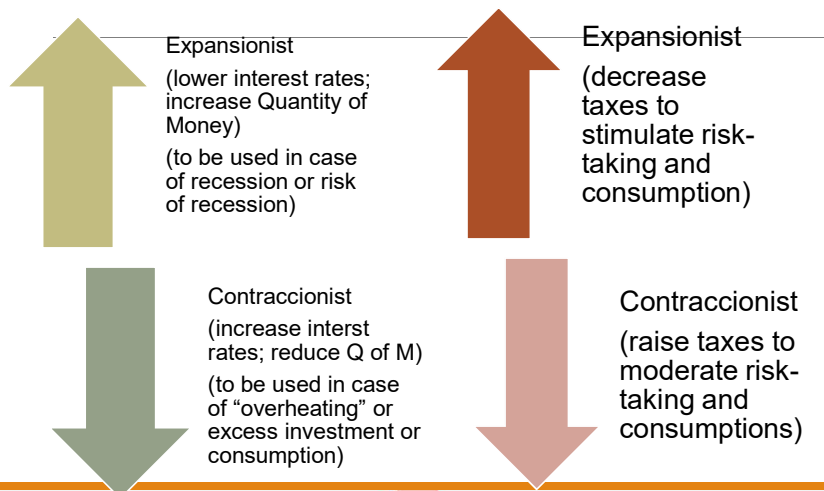
Countercyclical Expenditure



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Monetary and Fiscal Policies



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