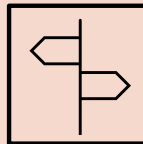


ECONOMIC AND BUSINESS HISTORY 23/24

LECTURE 13: HOW (NOT) TO SOLVE A GREAT DEPRESSION



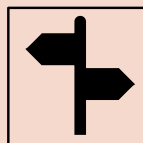
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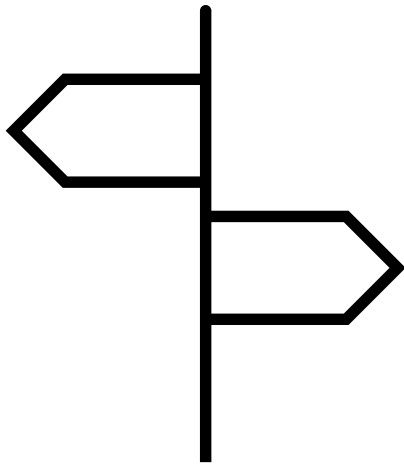
1. Pre-GD Policy



2. Interventionism



3. New Policies



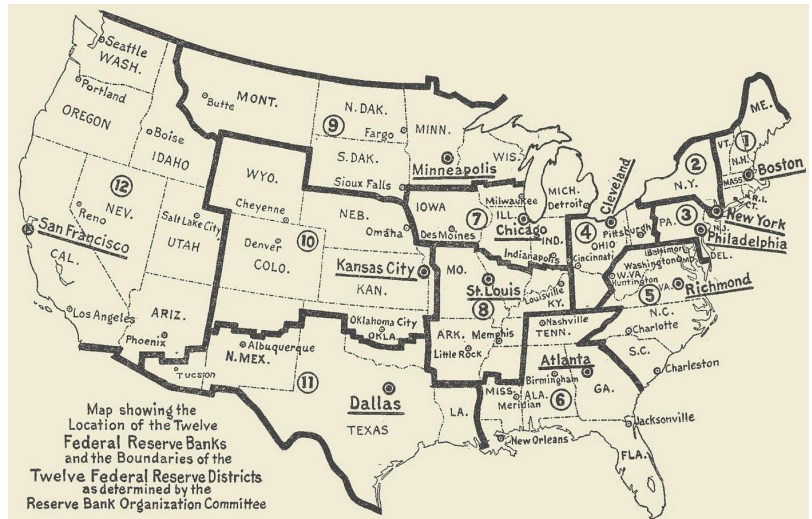
1. Pre-GD Policies

Liberal Policies (pre-1930s)

- The 1929 crisis seen as temporary, as V- or U-shaped ‘automatic’ recoveries had been the norm: 1883, 1891, 1921
- Trust in market and ‘classical economy’ price mechanisms:
 - Changes in prices expected to correct excess production or scarcity, with no need for state policies and incentives
 - The role of the State was thus twofold:
 - Keep balanced state budgets (deficit zero)
 - Provide monetary stability (typically by adopting gold standard)
 - By doing so, investors and businesses could regain confidence to find the new ‘smart’ investments and growth would resume

The Federal Reserve Bank System, 1930s

- The FED had been created in 1913, in the wake of a Banking Crisis of 1907.
- Thus, the FED's role was to keep the stability and liquidity of the Banking system (not employment or output)



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Monetary Policy

- Monetary policy (especially, the setting of the discount and reserve funds interest rates) was thus essentially thought as a means to stabilize the sector:
 - RESERVE FUNDS RATE - interest paid on funds that banks hold in their reserve accounts at their Federal Reserve bank
 - DISCOUNT RATE - is the interest rate charged by the Fed for loans it makes
- Thus, during the GD, the key concern of the FED was the liquidity of the banks, though there was no decisive lowering of interest rates to stimulate investment

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Failure

- 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 recovery of investment levels
- Nothing seemed to stimulate investment and employment

| 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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2. Interventionism

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, unemployment)

GD changed liberal policies for...

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

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 Loughheed 1999: 173.

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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
- ✓ Idea that Socialism as an economic system to promote development
- ✓ Need for a 'Big Push'

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The NAZIs: Guns or Butter?

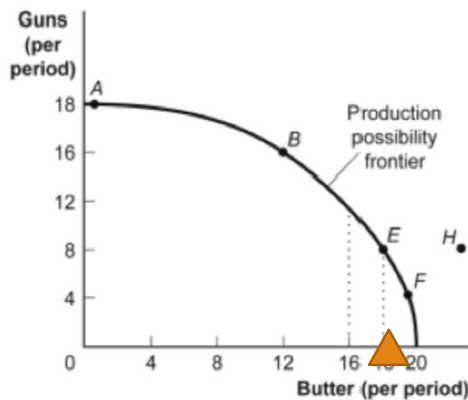
‘We can live without butter, but not without guns, because butter does not fire’
(Goebbels)

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

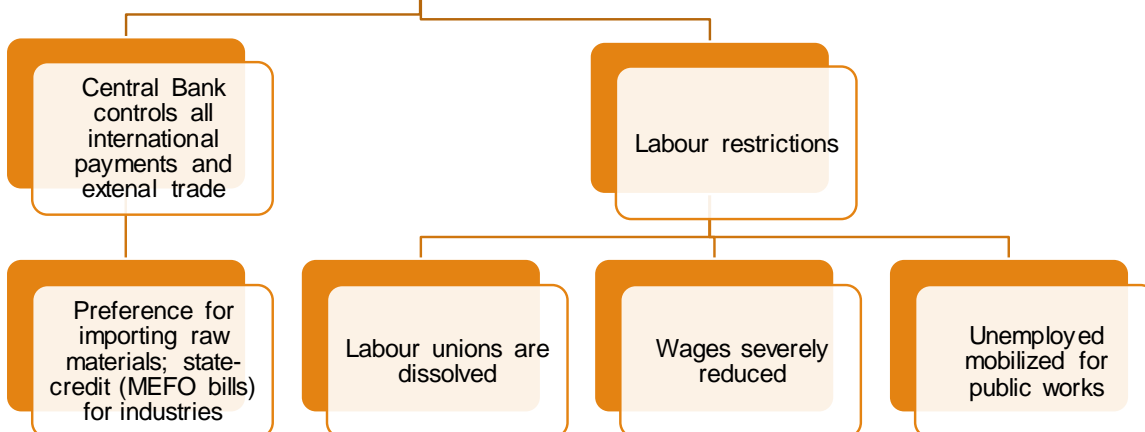
Figure: Guns and Butter



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“Guns, no butter!”



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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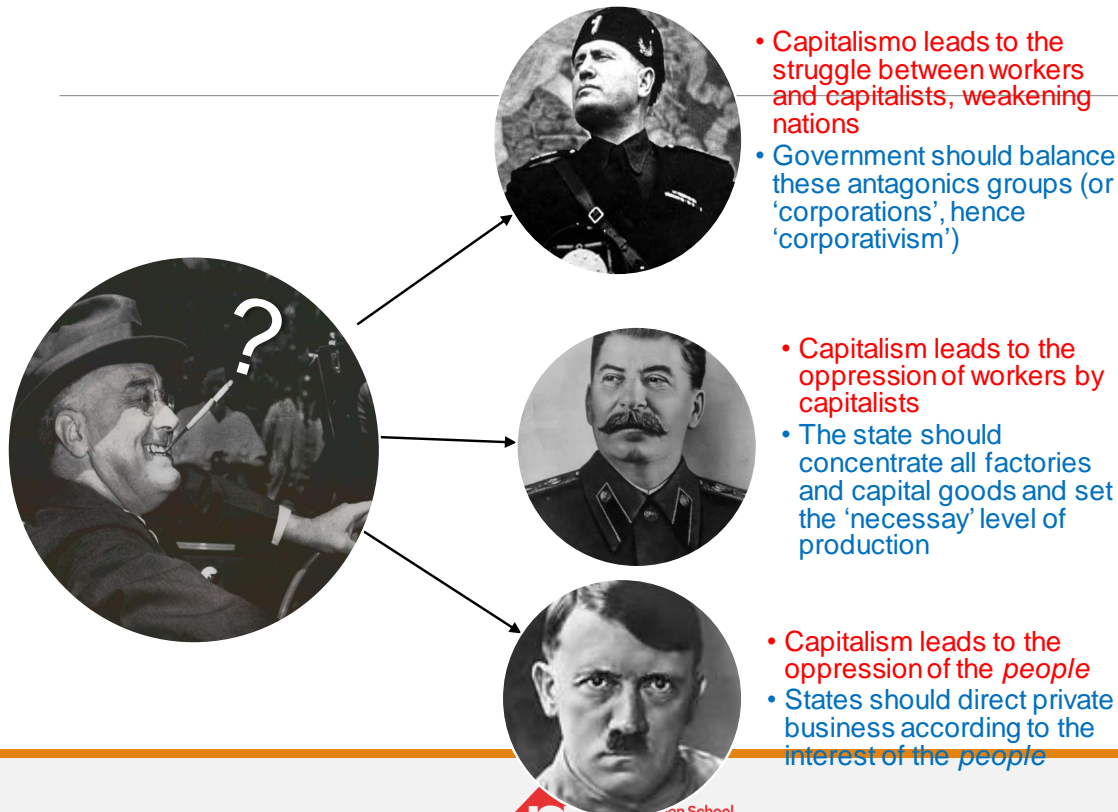
The search for new policies was on...



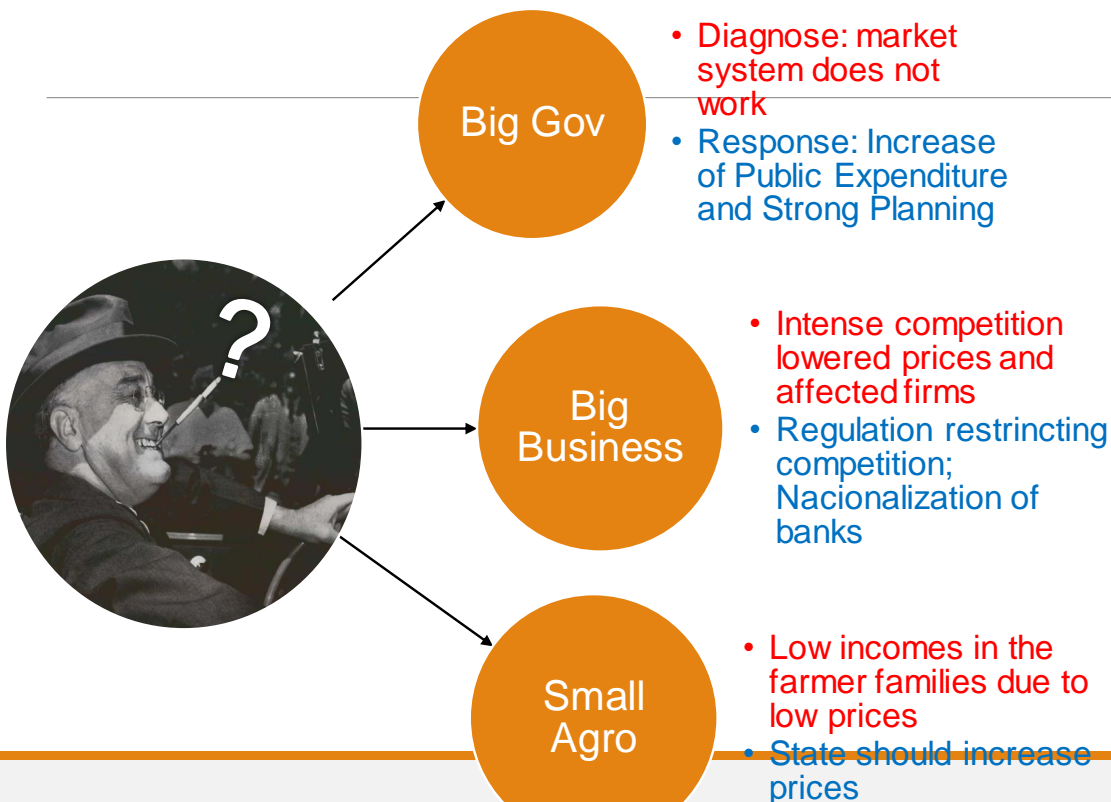
Léon Blum (French prime-minister and leader of the left coalition (*Front Populaire*) in 1936-8



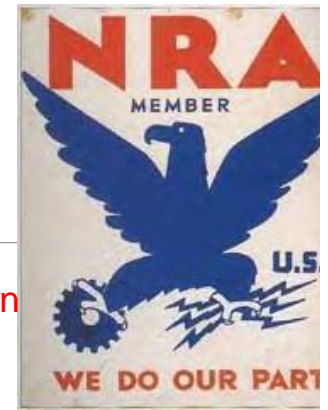
New Deal (distant) cousins



Interest groups influenced ND policies



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

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

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)

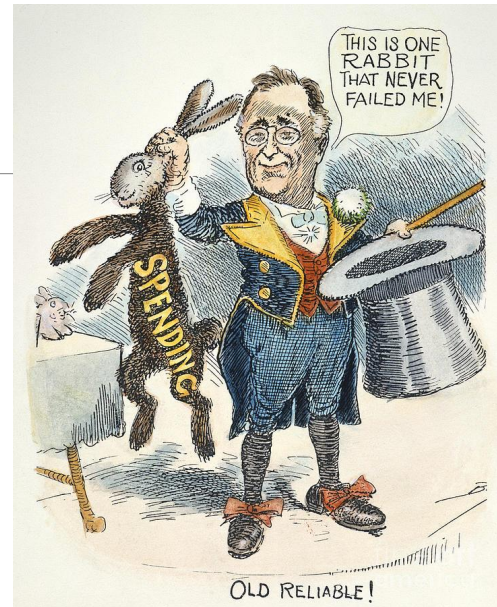
From 1935, the budget started to show deficits

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

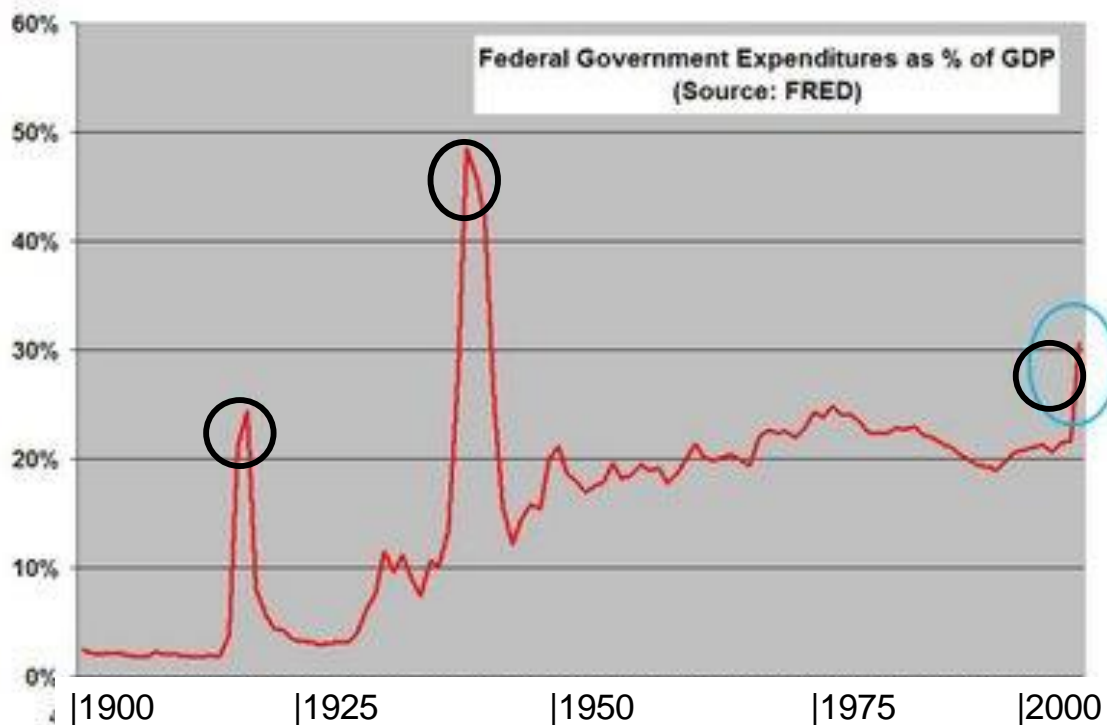
Gov justifies the expenditure as a temporary solution, as a strategy

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 FED contributed with low interest rates)

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

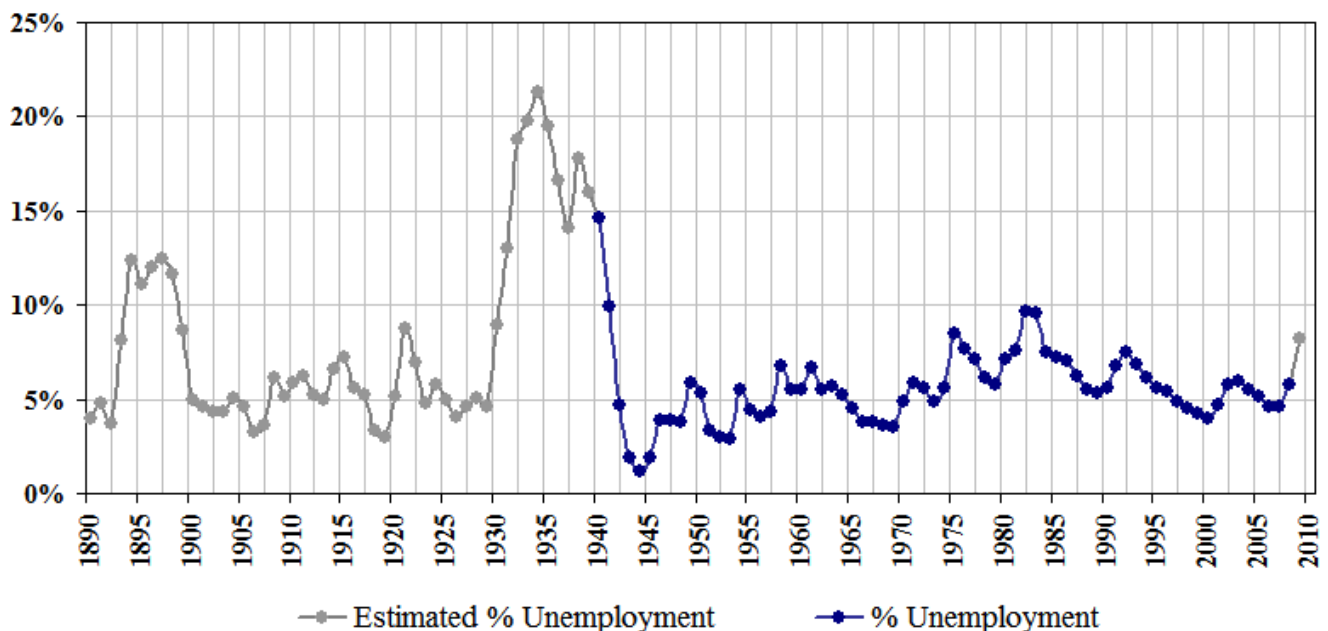


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Unemployment Rate in the US (1890-2008)

United States - Unemployment Rate (1890 - 2008)



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