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Note by the Secretary-General

on the

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Taking the world as a whole, recovery from the deep trough of 1932 was practically complete by the middle of 1937: the volume of world trade — in spite of a whole complex of new restrictions and the virtual absence of long-term capital movements — had reached nearly the same level as in 1929; surplus stocks of staple products had been almost entirely absorbed; industrial activity (excluding the U.S.S.R.¹) was some 6% higher than in the previous peak year of 1929; the number of workers in employment was approximately the same as in 1929, though — owing to the increase of population in the intervening years — unemployment was still about 10% higher.

Already in the spring of 1937, however, the advance appeared to be slowing down; a severe collapse of stock exchange values — notably in the United States and the United Kingdom — and a sharp fall in raw-material prices on world markets indicated a growing pessimism in the business world and formed an ominous prelude to the decline in industrial production which began in the United States in August and in a number of other countries in the course of the second half of the year. The recession which then began and continued throughout the first half of 1938 is clearly reflected by the indices given above. Between the second quarter of 1937 and the second quarter of 1938, world industrial production (excluding the U.S.S.R.) declined by 19%, the quantum of world trade fell by 15%, while stocks of primary commodities increased by 23%. Concurrently with the fall in industrial production, unemployment has shown an increase in most countries. Vigorous efforts have been made through Governmental measures and private restriction schemes to curtail the output of primary commodities, which — on an annual average — was 10% higher in 1937 than in 1929; but, even where such measures have been effective, they have not been able to keep pace with the shrinkage in demand, and there has consequently been a serious accumulation of unsold stocks.

¹ For the U.S.S.R. no data are as yet available, except a provisional index covering the whole year 1937, showing production at 424% of the 1929 level. On the basis of this figure, the world index including the U.S.S.R. works out at 118 for 1937, as compared with 103 if the U.S.S.R. is excluded. The exclusion of the U.S.S.R. from the world index of industrial production does not materially affect the comparability of that index with the index of the quantum of world trade, as the share of the U.S.S.R. in the latter is relatively small.

The general level of prices has fallen appreciably in most countries. Not only has this fall acted as a direct check on business enterprise, but it has also given rise to disparities and divergences in the price structure which are typical of a period of depression and liable to disturb the balance of economic relationships both between producers and consumers and between different classes of producers. In particular — as is usually the case in such circumstances — prices of agricultural products have fallen more than those of manufactured articles; the price “scissors” have widened once more, and the terms of exchange in international trade have moved to the disadvantage of countries producing primary commodities.

Such are the main general features of the setback which the world economy has experienced in the past twelve months. Attention must be drawn, however, to the wide dispersion of tendencies as between different areas. How divergent the experience of individual countries has been is shown by the summary table given below covering twenty-two countries for which estimates of industrial production are published on a monthly or quarterly basis. In this table, a comparison is made between the most recent month or quarter in 1938 for which the index is available and the corresponding period in 1937. From the third column of figures, it can be seen at once that the percentage changes show very large deviations ranging, in fact, from a decrease of 32.5% in the case of the United States to an increase of 21.3% in the case of Latvia. The decreases, however, predominate, and the list is headed by the United States — the greatest industrial country in the world.

Indices of Industrial Production.

(1929 = 100.)

Country	Months compared	1937	1938	Percentage increase (+) decrease (-)
United States	VI	95.8	64.7	- 32.5
Netherlands	V	97.5	69.1	- 29.1
Belgium	VI	90.1	67.9	- 24.6
Canada	VI	102.5	87.5	- 14.6
France.	IV	75.3	65.2	- 13.4
Czechoslovakia	V	99.8	88.4	- 11.4
United Kingdom	IV-VI	124.6	113.7	- 8.7
Finland	VI	137.5	127.5	- 7.3

Country	Months compared	1937	1938	Percentage increase (+) decrease (-)
Italy	V	106.9	99.9	- 6.5
Sweden	VI	148	142	- 4.1
Roumania	III	134.6	131.4	- 2.4
Estonia	VI	131.1	128.1	- 2.3
Hungary	I-III	135.9	132.9	- 2.2
Norway	V	127.0	125.3	- 1.3
Denmark	VI	136	136	± 0
Japan	IV	172.7	174.6	+ 1.1
Chile	VI	130.1	136.8	+ 5.1
Germany	VI	117.5	124.8	+ 6.2
Greece	III	152.7	165.0	+ 8.1
Poland	VI	84.6	91.7	+ 8.4
Bulgaria (1934/35 = 100) .	V	115.1	136.8	+ 18.9
Latvia	V	142.2	172.5	+ 21.3

It is a remarkable fact that industrial activity has declined most steeply in those countries where, prior to the onset of the new slump, recovery from the previous depression had been smallest, and that, conversely, the countries where production had recovered substantially beyond the previous peak level of 1929 have shown, on the whole, a high degree of resistance to the depressive influences. Of the twenty-two countries included in the table, the six which show the sharpest percentage decrease are the only ones (apart from Poland) where the index of production in the spring or early summer of 1937 was below the level of 1929 or only very slightly above it. This fact would suggest that the present recession can scarcely be attributed in any marked degree to excessive investment and capital expansion in the preceding period of recovery.

The causes of the setback in the United States have been discussed in detail elsewhere.¹ In the latter part of 1936 and in the first quarter of 1937, there occurred a sharp rise in industrial costs — through a general increase in wages and, owing to speculative forward purchases, in raw-material prices — while the expansion of demand which would have been necessary to neutralise this rise in costs was checked by a reduction in Government spending and certain measures affecting the banking

¹ In addition to the relevant publications of the Economic Intelligence Service — *World Economic Survey, 1937/38*; *Money and Banking, 1937/38*, Vol. I (Monetary Review); and *World Production and Prices, 1937/38* — reference may be made in particular to the memorandum annexed to the latest report of the Financial Committee ("Some Observations on the General Situation"), document C.227.M.129.1938.II.A(Pt.II).

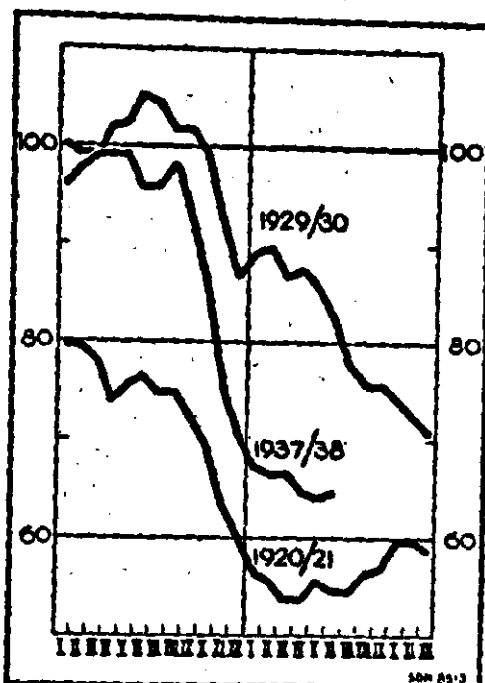
system. In France, there was an even steeper rise in production costs, while monetary demand tended to be restricted by the expatriation of capital funds.

The decline in industrial activity which ensued in the United States in the last five months of 1937 was exceptionally rapid. As is shown by the diagram opposite, the fall was both steeper and deeper than in 1920/21 or 1929/30.

A decline of this magnitude in a country of the economic importance of the United States could not fail to have far-reaching effects on the rest of the world. Thus, in view of the leading position of the New York Stock Exchange, the violent slump in American security values had a direct effect on the capital markets of most other countries. More important still, the United States normally absorb a very large proportion of the total world imports of raw materials, and it is therefore not surprising that the sudden decline in industrial activity in the United States should have exercised a disturbing influence on commodity markets throughout the world. In the first half of 1938, the value of total imports into the United States was as much as 42% lower than in the first half of 1937. As a result, there was an abrupt change in the country's balance of trade, and an appreciable strain was thus imposed on the rest of the world.

*Industrial Activity
in the United States.*

1920/21, 1929/30 and 1937/38.
(1929 = 100.)



Foreign Trade of the United States.

	First six months of:	
	1937	1938
	\$(000,000's)	
Exports	1,507	1,572
Imports	1,622	943
	<hr/>	<hr/>
Balance	- 115	+ 629

Apart from raw-material-producing States, some of the lesser industrial countries of Europe — notably the Netherlands, Belgium and Czechoslovakia — whose domestic activity is highly sensitive to conditions in foreign markets, felt the blast almost immediately, as did Canada, whose economic life is intimately connected with the United States. In the table of industrial production indices given above, these countries accordingly show very considerable declines in industrial activity from 1937 to 1938. The United Kingdom — which comes next in the order of decrease in that table — was similarly affected by the recession in the United States, both directly through the reduction in American purchases, and indirectly through the fall in the purchasing power of raw-material-producing countries. Thus, it was in the textile industry — a typical export industry — that the slump first made itself felt in the United Kingdom. Between the second quarter of 1937 and the second quarter of 1938, industrial activity in general fell off by 8.7% ; textile production alone, however, showed a drop of 21.3%. The British cotton industry, after a brief period of relative prosperity in 1936 and early 1937, has thus fallen back into a state of acute depression ; in June 1938, the proportion of unemployed to the total number of workers in that industry was over a third, as compared with one-tenth a year earlier. This does not mean, however, that the recession in the United Kingdom can be regarded merely as a passive reflection of the contraction of trade in the United States and other external markets. Recent indications (such as a drop of 46%¹ in the domestic consumption of steel and iron from December 1937 to June 1938) suggest that the business recession in the United Kingdom has to some extent influenced world economic conditions as an independent factor. This is not surprising in a country which had experienced five years of continuous advance and which had naturally reached a state of relative saturation in certain spheres of private investment such as building.

Only two industrial States — Germany and Japan — figure in the small group of countries where production continued to expand between the first half of 1937 and the first half of 1938.

¹ Index of *The Economist*, excluding seasonal variations.

The Japanese economy has been placed under extensive State control of production, prices and foreign trade in order to meet the military requirements arising from the conflict with China. The slight increase in the total index of industrial production from April 1937 to April 1938 conceals a 10% drop in the production of consumers' goods and an increase by 17% in the output of what are described as "investment goods". Behind her rigid barrier of trade control and exchange restrictions, Germany has been able to increase further her industrial output, mainly for purposes connected with military equipment and the development of domestic supplies of substitute materials. Although activity has thus been kept at a high level in Germany, signs of strain have become apparent: with the deterioration in foreign markets, exports have fallen and the trade balance has turned passive; the shortage of productive resources has become acute, and labour has been made liable to conscription for State requirements; financial stringency has grown with increased taxation and increased Government borrowing in the open market, and a serious decline in security values has taken place on the stock exchange in recent months.

Industrial activity in the agricultural States of Europe appears, on the whole, to have been well maintained. The latest indices for Latvia, Bulgaria, Poland and Greece show, indeed, a substantial increase as compared with the corresponding period last year. Though exports have in some cases (as, for example, in Hungary, Poland, Roumania and Yugoslavia) been lower in the first half of 1938 than a year earlier, the products of these countries have not, generally speaking, suffered as heavy declines in price as certain primary commodities produced in countries outside Europe. It appears, in fact, that world market prices of foodstuffs have, on the whole, been somewhat better maintained than prices of industrial raw materials such as rubber, cotton, wool, non-ferrous metals, etc. Among foodstuffs, moreover, those of animal origin, which form a relatively large proportion of the exports of European agricultural countries, seem to have fared better than those of vegetable origin; it is this fact which explains the continuance of relatively prosperous conditions in a country like Denmark.

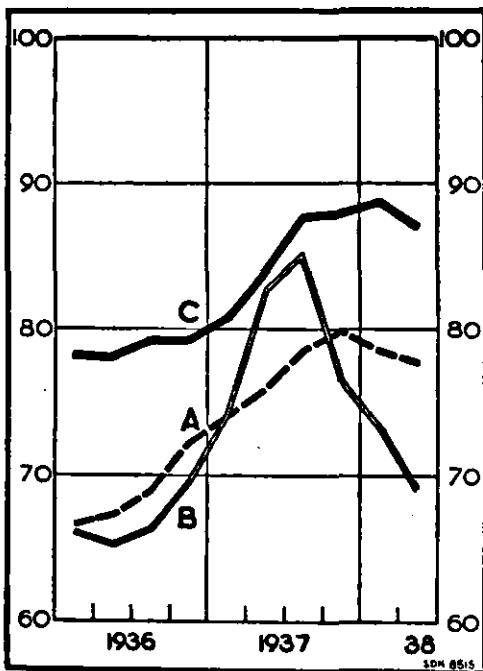
The general deterioration in the terms of exchange of agricultural and mining States in their trade with industrial countries

United Kingdom : Price Movements in External Trade.

(Sterling prices.)

Quarterly movement ;
1929 = 100.

- A Prices of food, drink and tobacco imported.
- B Prices of raw materials imported.
- C Prices of manufactured articles exported.



is probably one of the most disturbing elements in the present situation. How suddenly price relationships in international trade have changed is brought out by the diagram opposite relating to the import prices of foodstuffs and raw materials and the export prices of manufactured articles in the trade of the United Kingdom, which is highly diversified and hence likely to illustrate world tendencies accurately. It is clear from this diagram that, although foodstuffs have fallen less in price than raw materials, both have fallen relatively to manufactured articles. Partly as a result of this change in price relationships, the value of exports from nearly all primary producing countries has fallen off considerably, while the value of imports into these countries has fallen less or has continued to rise.

Exports from and Imports to Certain Agricultural-exporting Countries, 1937 and 1938.

(National currencies.)

Country	Months compared	Percentage increase (+) or decrease (-) in	
		Exports	Imports
Argentina	I-VI	- 51	+ 12
Australia	I-VI	- 11	+ 23
Brazil	I-III	- 6	+ 32
Canada	I-VI	- 21	- 12
Chile	I-VI	- 34	+ 34
Colombia	I-IV	- 4	+ 11

Country	Months compared	Percentage increase (+) or decrease (—) in	
		Exports	Imports
Denmark	I-VI	+ 4	— 4
Egypt	I-VI	— 32	± 0
Hungary	I-VI	— 14	— 8
India	I-VI	— 32	+ 5
Iran	I-VI	— 1	+ 22
Latvia	I-VI	— 9	+ 3
British Malaya	I-V	— 35	— 15
Netherlands Indies	I-VI	— 22	+ 2
New Zealand	I-VI	— 12	+ 5
Peru	I-VI	— 17	+ 28
Poland	I-VI	— 5	+ 11
Portugal	I-V	— 10	— 9
Roumania	I-VI	— 33	+ 2
Turkey	I-VI	+ 1	+ 57
Yugoslavia	I-VI	— 15	+ 9

The divergent movement of the exports and imports of agricultural and mining States has arisen partly from the time-lag which normally elapses between a change in the incomes earned by the countries in question and the consequent change in their purchases of imports. The detailed trade returns show that the recent growth in imports into these countries is largely accounted for by machinery, motor-vehicles, electrical equipment and other capital goods, the orders for which had probably been placed some considerable time earlier, when trade was still prosperous. In the course of the inevitable adjustment of the import trade of primary producing countries to their reduced purchasing power, the volume of world trade is likely to suffer a further decline.

In the meantime, the contraction in exports and the increase in imports of these countries reduce their active trade balances and hence weaken their ability to make payments on account of foreign debts or to replenish their gold reserves. The recent tendency to tighten up exchange restrictions once again is clearly traceable to these changes in the currents of trade. The opposite changes in the combined trade accounts of eight creditor nations are illustrated in the following figures, which, for 1938, disclose a sharp drop in the aggregate import surplus of these countries, — a distinct reversal of the trend which had prevailed in the preceding recovery period.

Total Trade of Eight Creditor Countries.¹

First six months of :	1935	1936	1937	1938
		§ (000,000's)		
Exports	4,382	4,922	6,173	5,157
Imports	3,356	3,520	4,365	4,214
Balance	<u>-1,026</u>	<u>-1,402</u>	<u>-1,808</u>	<u>- 943</u>

* * *

All the evidence thus goes to show that the setback which has taken place is one of major dimensions, and has left no part of the world economy undisturbed. It must not be assumed, however, that there is any close analogy between the present situation and the depression which began in 1929. No conclusions regarding the duration or amplitude of the present setback can possibly be drawn from the course of the last depression : the world of to-day differs in too many essential respects from the world of 1929. On the one hand, there are, it is true, elements in the present situation which compare unfavourably with conditions eight or nine years ago and which militate against a speedy revival of private business activity. There is, for example, the uncertainty regarding the mutual exchange value of the world's currencies, which impedes activity in industries working for foreign markets, and which leads to violent " scares " and shifts of liquid funds from one currency into another or into and out of gold. More serious still, there is the paralysing uncertainty of the international political outlook, which inevitably tends to discourage the exercise of economic initiative on the part of private individuals.

On the other hand, however, comparison with 1929 reveals a series of favourable factors which permit of a more hopeful view of economic prospects. In the first place, the world is not suffering to-day from such an acute agricultural crisis as it was in 1929, when surplus stocks of primary commodities had been accumulating and prices declining for some years previously. The exceptionally large crops which are being harvested this year may have adverse repercussions on the purchasing power of agriculturists. But in many countries Governments

¹ The United Kingdom, the United States, France, Belgium, the Netherlands, Sweden, Switzerland, Ireland.

have devised methods to deal with a situation of this kind. In the United States, in particular, the new agricultural legislation adopted early this year has given the authorities extensive powers for the curtailment of production and the withdrawal of stocks from the market. Furthermore, the international restriction schemes which are in operation for a number of staple commodities have been very promptly tightened up with the fall in demand; in the case of rubber and tin, for example, export quotas were cut by one-half from the second half of 1937 to the third quarter of 1938. In the presence of this general determination to adjust current supplies to the shrinkage in demand, it is difficult to conceive of a rise in world stocks on the same scale as in 1929-1932.

Secondly, the Governments of some of the great creditor nations of the world appear happily to be less disposed than in the last depression to resort to palliatives which tend merely to shift the burden to other — and probably weaker — members of the world economy. In 1930, a serious and general increase in import duties was effected in the United States, and in the following two years tariff protection was introduced in the United Kingdom. At the present time, the United States are pursuing a programme of trade agreements which has already produced encouraging results in liberalising international trade. A trade agreement between the United States and the United Kingdom is now, it appears, in the last stages of preparation, and will, when adopted, undoubtedly constitute a stimulating factor in the economic revival of the world at large.

A third and very striking contrast between the present situation and the period 1929-1932 is to be found in the sphere of money and credit. Instead of the world shortage of gold which was feared in 1929, there is now a plethora of gold, owing partly to the greatly increased annual world output of gold and partly to the higher price at which, as a result of currency devaluations, gold reserves are valued. The distribution of monetary gold reserves, it is true, has become still more unequal; but some advantage can at least arise from the fact that the bulk of the world's gold is held in the centres which are the most likely to influence the development of commodity prices in the world market. In most countries, banking systems to-day are sound, commercial credits abundant, interest rates low and business firms liquid. Even the turning-point from prosperity to recession

which occurred in a number of countries in 1937, was hardly marked by any serious financial stringency, and since then, the business contraction seems in some cases to have accentuated the liquidity of money markets. There are no signs of a recurrence of the disastrous deflation of credit which developed in the years 1929-1932.

Lastly, there has been an important change in the attitude of Governments and public opinion towards the general phenomenon of economic fluctuations. There is less willingness to let a depression run its course. There is greater readiness on the part of Governments to intervene actively by monetary or budgetary policy, public works and other measures to restore production and employment when a decline has taken place.

The numerous and extensive measures which have already been adopted in many parts of the world to deal with the new recession bear witness to this change in attitude. The recent recovery measures have been particularly wide in scope and energetic in character in the United States. The central feature of the American recovery policy is the resumption of large-scale deficit expenditure for social relief, public works and other purposes. To facilitate public and private borrowing, the authorities have at the same time effected a reduction in the reserve requirements of banks and a large expansion of the cash balances of the latter through the abandonment of gold "sterilisation" on the part of the Treasury. In addition, financial encouragement has been given to residential house building; modifications have been made in certain taxes which were believed to have restrictive effects on investment; and a very extensive relaxation has been effected in the official regulations governing commercial bank loans. Similar measures have been taken in many other countries; public works by loan expenditure have, for example, been undertaken recently in the Argentine, France, Hungary, New Zealand, Poland and Yugoslavia. In Switzerland, a scheme of public works is at present under consideration. In Sweden, an elaborate plan for State expenditure in times of depression has been approved by Parliament and needs only a decision of the Government to be put into effect. In the United Kingdom, the authorities appear to have carried out a moderate expansion in the cash basis of the credit system during the first half of 1938. It seems, on the whole, that the national measures taken

to promote recovery from the present slump have been directed mainly towards expanding domestic money incomes. Measures of a different type, which — by import restriction, export subsidies, exchange depreciation, etc. — stimulate activity in one country at the expense of the rest of the world, have so far been relatively rare. If no new disturbances occur, this circumstance itself should be conducive to the success of the measures adopted.

In the United States, a revival of business seems, in fact, to have begun since the second half of June 1938. The improvement has been halting and hesitant, but perceptible enough to reflect itself in almost every index of economic activity. There has been a striking rise in industrial share values, amounting to nearly 30% between the middle of June and the end of August 1938 ; but this would have been of little significance had it not been accompanied by a recovery in prices of raw materials, an increase in consumers' purchases, a steady revival of steel production, an expansion in building activity and an improvement in railway traffic. It is too early to judge whether these latest events constitute the beginning of a new and sustained upward movement. It is well to remember that general but short-lived improvement has frequently occurred in previous depressions long before recovery had established itself on a solid basis. In view of the decisive influence of the United States on world economic conditions, the next developments in that country will be watched everywhere with the greatest attention. It is to be hoped that means will be found in the United States to revive the incentive to private capital outlay, without which — in an economy based on private profit and free individual enterprise — a lasting recovery has proved to be incapable of achievement.

In the industrial areas outside America, the manufacture of armaments absorbs a growing share of total productive resources. The view is sometimes expressed that the increase in armament production will help to overcome the present slackening of normal economic activity. This view may be questioned on several grounds. In the first place, the growth of armaments itself breeds an atmosphere of fear and insecurity which is hardly conducive to the maintenance — let alone the expansion — of private economic activity. Further, in a wealthy community where the bulk of productive resources is employed to maintain

a high standard of consumption, to replace and extend continuously a large equipment of fixed capital, etc., even large Government expenditures on armaments may be insufficient to offset a recession in the sphere of private production. This is particularly so when the expenditure in question has to be financed wholly or partly by taxation or other methods which tend to reduce employment in the civilian sector by as much as they increase it in armament production. In the United Kingdom, for example, a five-year rearmament programme which came into effect on April 1st, 1937, did not prevent a fall in general employment and business activity a short time later. It should be remembered that over two-thirds of the expenditure under that programme is covered by taxation.

Finally, account must be taken of the primary producing countries in estimating the chances of an early world recovery. The national incomes of the majority of these countries have been seriously reduced by the fall in the prices of their export products. A parallel reduction in their imports has not yet occurred, but must be expected soon unless the downward spiral in world trade is arrested in time by a revival of demand in the industrial States.

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One of the dangers of the present setback is that it may give rise to a further advance of economic nationalism. Countries may be led to adopt measures of self-protection which temporarily alleviate domestic conditions at the expense of the outside world, but which end by accentuating the general depression. The world is still suffering from the contraction of markets which seems to have been one of the permanent results of the recovery measures of this type taken in the last depression. National recovery programmes are likely to be more genuinely successful in attaining their object if they are directed towards general expansion of capital outlay and consumers' income. If, however, the adoption of methods of the latter type is not general, they may in certain circumstances place a strain on the national balance of payments. It is important, therefore, that such genuine recovery measures as are adopted should be adopted simultaneously by the principal countries concerned. A certain measure

of international co-ordination can appreciably increase the efficacy of national action.

The short-term problems of economic fluctuations, however, should not be allowed to obscure our view of the long-run tendencies in the structure of the world economy. In a relatively short space of years, international economic relationships have undergone many vital changes. Currencies are no longer freely convertible into gold or into one another at fixed parities ; movements of capital for purposes of long-term development have come to a standstill ; migration of labour has likewise become a thing of the past. But probably the most far-reaching change has taken place in the conditions under which trade is conducted from country to country. Partly as a legacy of the great depression, restrictions on the international exchange of goods are to-day vastly more severe than in 1929. Moreover, in large parts of the world, foreign trade is no longer left to the initiative of the private business-man, but is closely regulated, if not actually conducted, by the State. One of the urgent problems of the present day is to establish a balance to devise workable methods of commercial intercourse between the regions where trade is State-directed and the regions where, in spite of all restrictions, trade remains in fact, and not only in law, a matter for individual enterprise and initiative.

It must, of course, be realised that the motives for the maintenance of the various kinds of trade restrictions are not everywhere the same. In some countries, policies of national self-sufficiency are pursued for military reasons. Obviously, no relaxation in economic barriers can be expected in these cases, unless and until there is a change in the underlying political conditions.

There is no doubt, however, that — taking the world as a whole — the bulk of existing restrictions are still intended to serve a more strictly economic purpose. At the sacrifice of the advantages of international specialisation, countries are aiming at a greater degree of independence in controlling their internal economic conditions. It would be futile to contemplate a radical reversal of this trend. Nevertheless, there remains ample scope for international co-operation and mutual consultation to the common advantage of all concerned. Indeed, the growth of State intervention in international economic relations presup-

poses a minimum degree of co-ordination without which avoidable friction and waste must occur at every step. Unilateral national attempts to solve international economic problems — and in the modern world there are few economic problems which are not international — cannot replace concerted co-operative effort between nations. International economic co-operation should not, moreover, be conceived merely in terms of international bargaining ; much can be done by reciprocal help on common problems and by co-ordination of national policies with like objectives. And there is no reason why such lines of action should not be pursued on a bilateral basis or among limited groups of nations.

It is from such mutual adjustment of national policies that some progress towards relaxing the network of trade restriction may naturally ensue. Not only are there many restrictive measures and regulations, introduced in the past to deal with some specific situation or emergency, which have become unnecessary and which could with advantage be removed ; but there are also other restrictions which could undoubtedly be attenuated by “ filing down the sharp points ” in international economic relations through co-operative and concerted action. There can hardly be a more effective means of improving standards of living than a revival of international trade. Particularly at the present time, when enormous armament expenditures direct productive energies to non-economic ends, the world can afford to leave no means untried to prevent a lasting deterioration in the general level of human welfare.
