

ECONOMIC INTELLIGENCE SERVICE

**WORLD
ECONOMIC SURVEY**

SEVENTH YEAR

1937/38

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WORLD ECONOMIC SURVEY

Seventh Year

1937/38

PREFACE

The object of this *Survey*, like that of its predecessors, is to furnish the general reader with an account of the more important economic developments during the past twelve months, based primarily on the information collected in the preparation of the more specialised studies contained in the other publications of this Service. The *Survey* is, however, more than a simple synopsis of these other publications, a list of which is given on page 2; it covers a somewhat wider field and in its preparation additional sources of information have been employed and assistance has been obtained from other national and international bodies — more especially from the International Labour Office.

The present issue has been prepared by Mr. J. E. Meade, temporarily attached to the Economic Intelligence Service, and the occasion of this change of authorship has been taken to reduce slightly the length of the volume.

As in other publications of the Economic Intelligence Service, the sign “—” indicates throughout that the figure is nil or negligible, “...” that the figures are not yet published, and “.” that information is not available or is non-existent. World and continental tables contain, as a rule, estimated figures for countries for which information was not available, so that they are complete and therefore comparable from year to year.

A. LOVEDAY,

*Director of the Financial Section and
Economic Intelligence Service.*

Geneva, August 15th, 1938.

Chapter I

THE DECLINE IN BUSINESS ACTIVITY

THE CHANGING ECONOMIC OUTLOOK IN 1937

The year 1937 marked for many countries a turning-point from expansion to contraction of trade activity. During the last quarter of 1936 and the first quarter of 1937, the prices of primary commodities rose with great rapidity.¹ This rise was caused by heavy industrial demand and by the expectation of the continued expansion of demand, combined with the knowledge that in many cases the production of primary commodities could not easily be expanded further. It was intensified by the prospect of heavy and increasing expenditure on rearmament when, in February 1937, the British Government announced its intention to spend £1,500,000,000 on arms in the course of the next five years. Meanwhile, international trade increased rapidly;² and this was true, not only of the value of such trade, but also of its quantum, which, in the second quarter of 1937, reached the 1929 level for the first time since the great depression. Rising prices and increasing demand caused a continual expansion in employment and production during the first half of the year.³ The rise in prices, employment and production in this period is illustrated for certain important countries in the graphs on pages 10 to 12.

In March and April 1937, commodity prices reached their peak and there followed a steady and serious decline, the underlying cause of which was the realisation that the future expansion of demand had been over-estimated. The more immediate occasions for the break in prices were a statement by President Roosevelt that prices had risen unjustifiably, a growing belief that the Government of the United States intended to reduce the dollar price of gold in order to curb the excessive rise in prices, and, in the United Kingdom, the announcement of a special tax on rising profits. As the graphs on pages 10 and 11 show, share prices in the United Kingdom had been falling since the beginning of 1937, and, in the United

¹ Cf. Chapter IV.

² Cf. Chapter VI.

³ Cf. Chapters II and III.

States, had reached their peak early in that year. In September, share prices in the United States fell abruptly, and this collapse on the stock exchange was followed by a sharp fall in production, employment, prices and business turnover. The rapidity of this general recession in the United States, which was as abrupt as any ever experienced by that country, is well illustrated by the movements of the indices of industrial production and of security prices.

There can be little doubt that, since the great depression which started in 1929, expansion or contraction of trade in one country exerts a less wide influence on trade activity in other countries. The abandonment of fixed exchange rates based on fixed gold values for different currencies, the application of exchange control, the imposition of import quotas and of tariffs — these and similar measures have to some extent isolated each national economy. It is now more possible than it was before 1929 for one important country to experience conditions of trade activity or inactivity which are out of line with the conditions experienced in other countries; and the amplitude and timing of the trade cycle in any one country may be less dependent than before upon conditions in other countries. In Chapter III, this fact will be illustrated by showing that recovery in industrial production proceeded less uniformly in the different individual countries between 1932 and 1936 than between 1925 and 1929. At the moment, it is sufficient to compare the developments shown in the graphs on pages 10 and 11 for the United States, the United Kingdom, France and Germany during the last slump. In the United Kingdom, both employment and industrial production regained the 1929 level by 1934, and by 1937 were considerably above it. In the United States, employment and production had not quite regained the 1929 level, even at their peak in the first half of 1937. In France, by 1937 there had been practically no recovery of industrial production and very little recovery of employment from the depression levels of 1932. In Germany, industrial production was in 1937 considerably above the 1929 level; and, unlike the situation in the United Kingdom and the United States, it showed no tendency to fall during the last part of the year.

But, in spite of the greater disparity that is now possible between the conditions of trade activity in different parts of the world, no country can remain unaffected by a major recession in any other important country. Even those countries which have most isolated themselves economically and which are likely to be the least immediately affected could not escape the influence of a collapse of purchasing power in the United States.

In 1937, the United States imported goods¹ worth \$3,012 million, while the total exports of all other countries of the world was worth \$22,727 million, so that the rest of the world sold 13.3% of its exports in the American market. If the American demand were therefore to shrink considerably, a large proportion of the world's exports would be directly affected; and, after a time, even those countries which were not directly affected would indirectly suffer as a consequence of the reduced incomes of those countries which were most directly affected. As American prices and incomes fell, American purchases would be reduced and American exports would be put on the world markets at lower prices. In both ways, pressure would be exerted on other countries. The following table shows how the foreign trade of the United States has changed during the present recession.

United States' Foreign Trade.

In U.S.\$ (000,000's)

Period	Imports			Exports			Balance		
	1936	1937	1938	1936	1937	1938	1936	1937	1938
1st quarter .	570.3	784.8	492.7	567.5	701.2	817.0	- 2.8	- 83.6	324.3
2nd quarter	583.1	838.5	...	568.0	806.2	...	- 15.1	- 32.3	...
3rd quarter	616.7	746.5	...	570.7	831.5	...	- 46.0	+ 85.0	...
4th quarter	653.9	642.5	...	712.8	956.4	...	+ 58.9	+313.9	...

The figures show a remarkable change of trend between the first and the second half of 1937. Imports increased in every quarter up to the second quarter of 1937, when they started to fall so rapidly that the figure for the fourth quarter of 1937 was lower than the corresponding figure in 1936. Exports, on the other hand, increased throughout 1937. In consequence of these changes, the excess of the United States' imports over her exports was considerably greater in the first two quarters of 1937 than in the corresponding period of 1936; but there was a considerable excess of exports in the third quarter of 1937 as compared with an excess of imports in the corresponding period of 1936, and in the fourth quarter of 1937 there was a much greater excess of exports than in the corresponding period of 1936.

Apart from the direct effect of an American recession upon the foreign trade of other countries, a stock-exchange collapse and business depression in the United States exerts immediately a depressing influence on the stock exchanges of other countries.

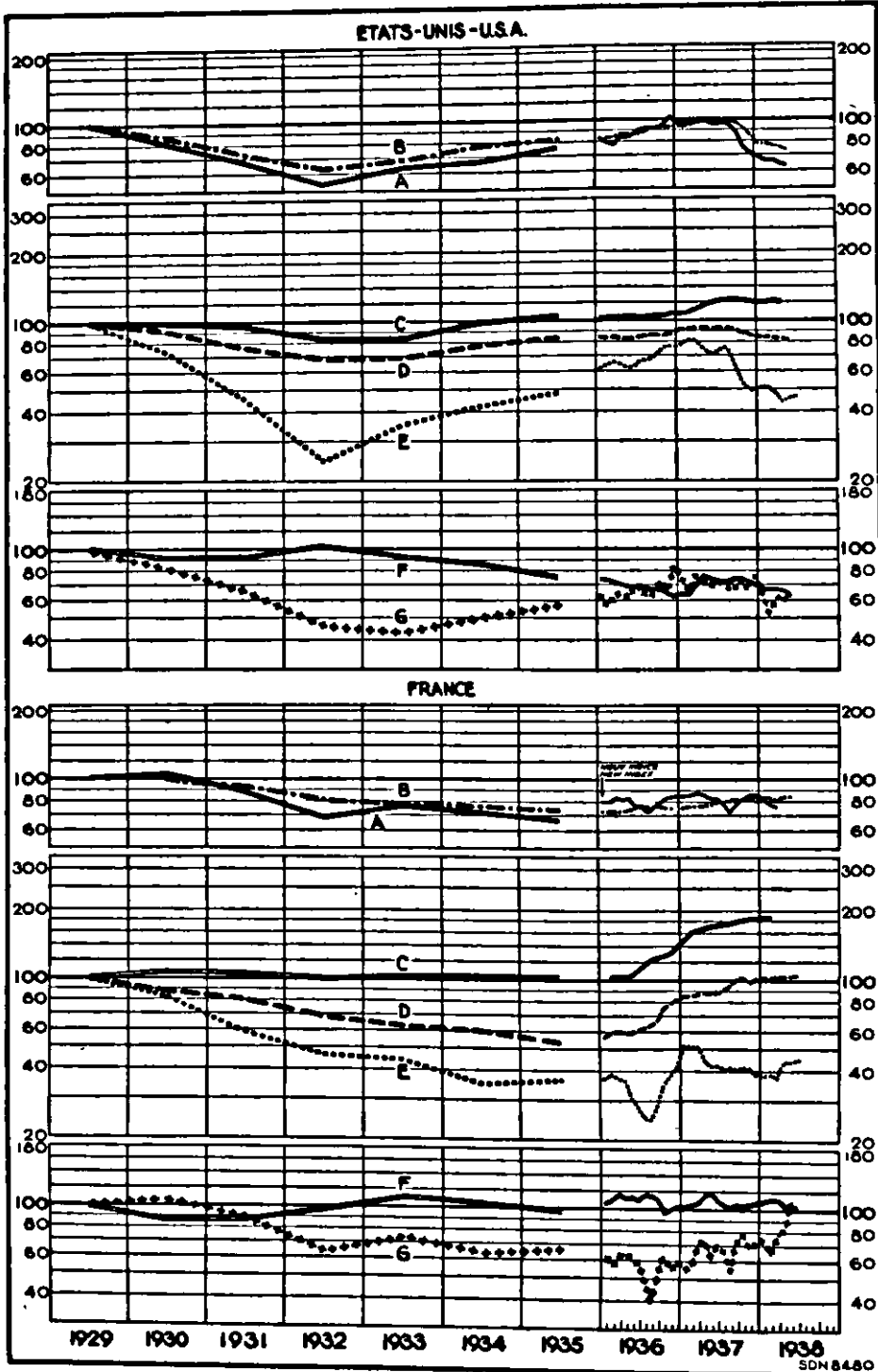
¹ Value f.o.b. at port of shipment.

General Economic Conditions in the United States and France.

(1929 = 100.)

- | | |
|---------------------------------------|--|
| A Industrial production. ^a | E Industrial share prices. |
| B Number employed. ^b | F Yield on long-term Government bonds. |
| C Money wage-rates. | G Bank clearings. ^c |
| D Wholesale prices. | |

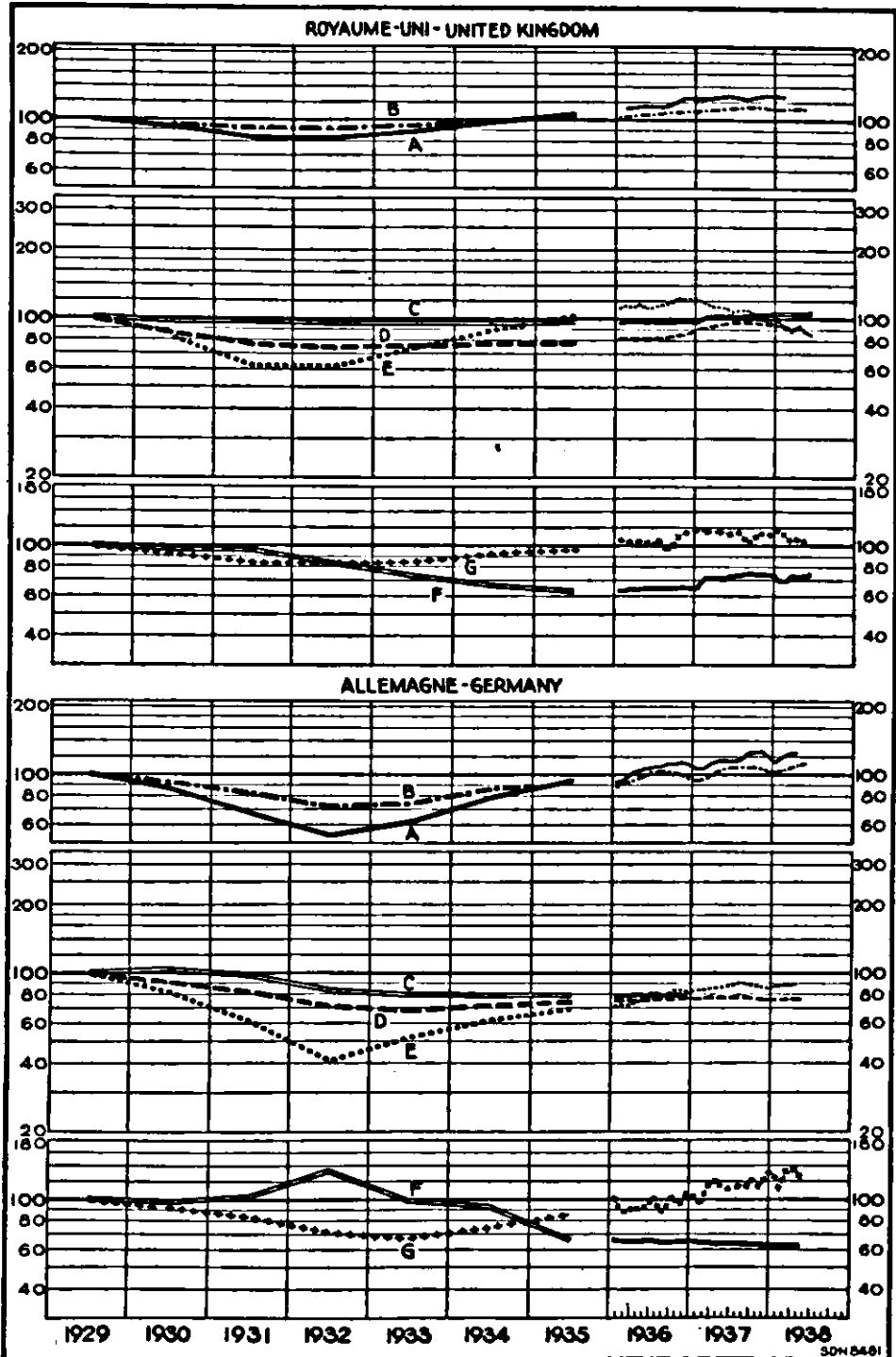
(Logarithmic scale.)



^a France: The apparent rise between 1935 and 1936 is due to the use of a new index.
^b France: Base 1930 = 100. ^c France: Clearings of Paris; U.S.A.: Bank debits outside New York City.

General Economic Conditions in the United Kingdom and Germany.
(1929 = 100.)

- | | |
|--------------------------|---|
| A Industrial production. | E Industrial share prices. |
| B Number employed. | F Yield on long-term Government bonds. ^a |
| C Money wage-rates. | G Bank clearings. ^b |
| D Wholesale prices. | |
- (Logarithmic scale.)

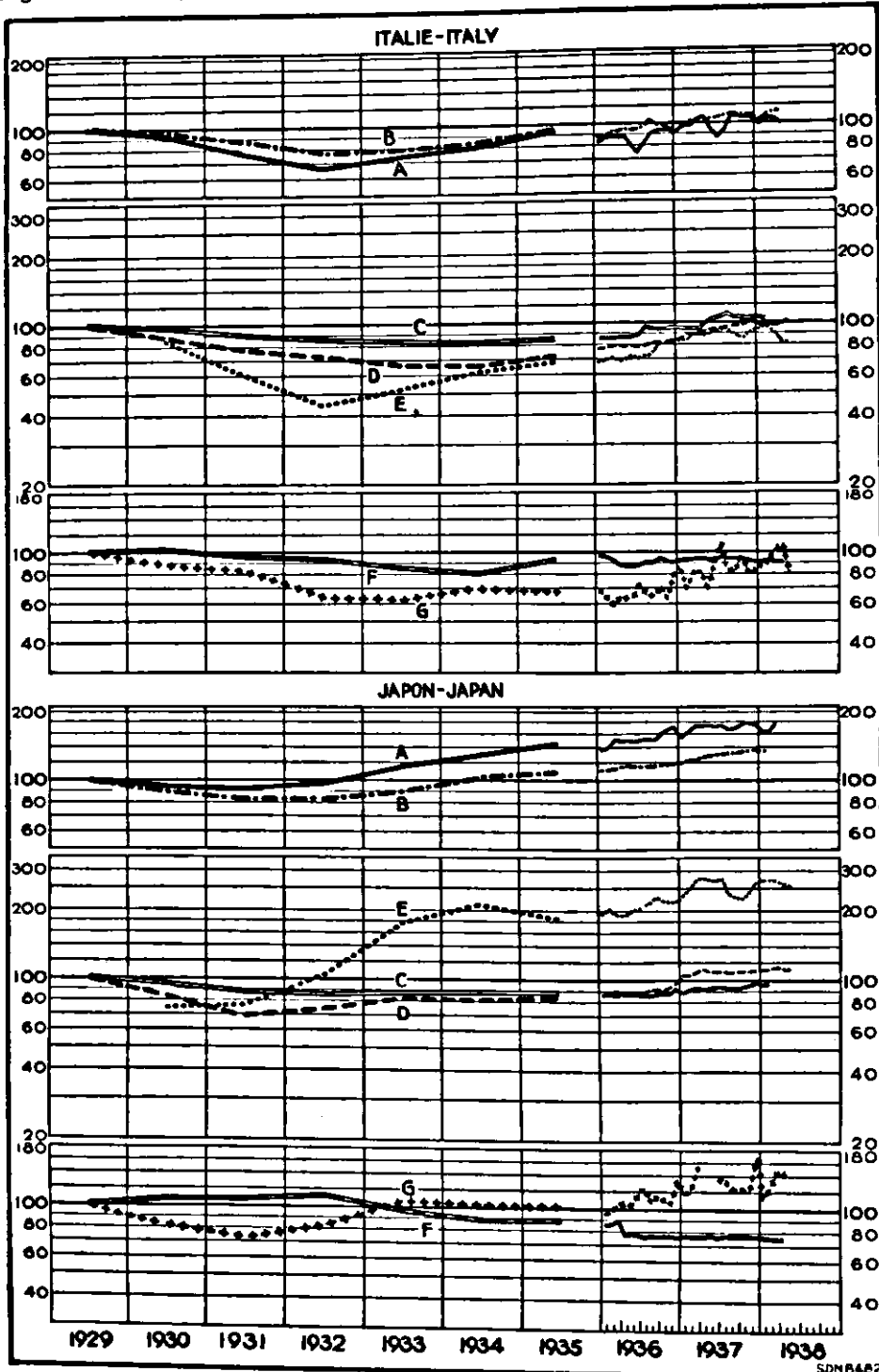


^a Germany: On April 1st, 1935, the 6% bonds were converted into 4½%. ^b Germany: Transfers; United Kingdom: Country and provincial clearings.

General Economic Conditions in Italy and Japan. (1929 = 100.)

- A Industrial production.
- B Number employed.
- C Money wage-rates.
- D Wholesale prices.
- E Industrial share prices.^a
- F Yield on long-term Government bonds.
- G Bank clearings.^b

(Logarithmic scale.)



^a Japan: Base 1930 = 100. ^b Italy: Clearings in eleven towns; Japan: Clearings in all clearing-houses.

This fact is illustrated in the graphs on pages 10 to 12 which show that, even in "autarkic" countries, such as Germany and Italy, share prices fell from the middle of 1937 in sympathy with the movement in the United States.

Again and again in this *Survey*, in the study of different countries and of different problems, it will be observed that, while the first part of 1937 was a period of expansion and of relative prosperity, the last part of the year was marked by a cessation of expansion or an actual contraction of activity. In February 1938, as this chapter is being written, the most pressing economic questions appear without doubt to be: whether the American setback is a relatively minor recession or the beginning of a major depression; whether adequate measures are being, or could be, taken to prevent it; and to what extent it will affect other countries. This *Survey* cannot attempt to give definite answers to these questions; but, by presenting the main economic events, it may aid in the formation of an opinion.

THE UNITED STATES OF AMERICA

There are certain marked features of the present American recession which it is useful to note at the outset. In the first place, the recession has been remarkably rapid. For example, during the first six months of the depression which started in September 1929, share prices fell by 24.6% and industrial production by 14.9%, whereas share prices fell by 33.4% and industrial production by 32.5% during the six months following August 1937. Moreover, this peculiarly rapid recession occurred at a time when activity was still at a comparatively low level. Indeed, industrial production in the United States had failed to regain the 1929 level, quite apart from having proceeded sufficiently to meet the increases in productivity that should have been made possible by the growth in population and by improvements in industrial technique. In November 1937, an unemployment census suggested that there were 10,870,000 wholly unemployed persons, after making allowance for the incompleteness of the census; and, in February 1938, President Roosevelt estimated that a further 3,000,000 persons had lost their occupations during the preceding three months. It is clear that the recovery had still far to go in order to provide full employment for labour. In one other way, this recession differed from most previous recessions. There was practically no stringency in the American money market and no rise in short-term interest rates before the recession; but in the long-term capital market there was a marked rise in interest rates

at the beginning of 1937, as can be seen from the graph on page 10.¹

As in every depression and recovery, activity in the industries producing capital goods, such as iron and steel, machinery and building materials, fluctuated much more violently than in the industries producing goods for current consumption. This is clearly shown by the production of investment goods and of consumption goods in the first of the two following graphs.

Indices of Industrial Production and Department Stores in the United States.

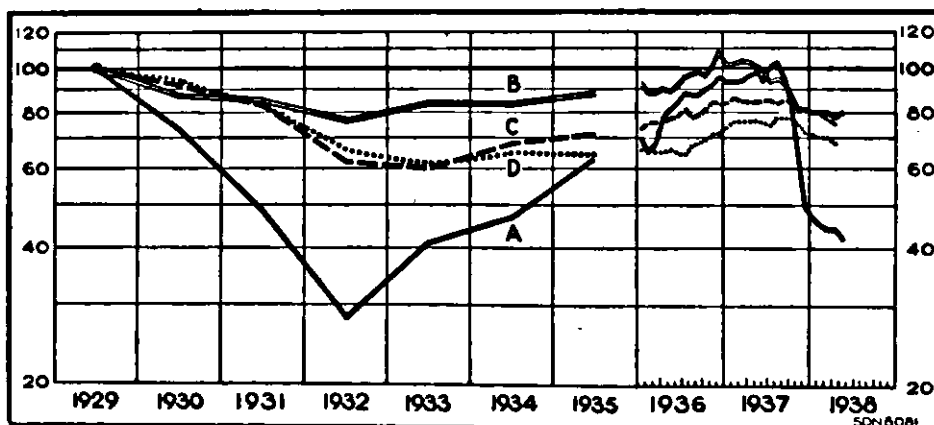
(1929 = 100.)

Industrial Production:
A Investment goods.
B Consumption goods.

Department Stores:
C Sales.
D Stocks.

(Logarithmic scale.)

(Adjusted for seasonal variations.)



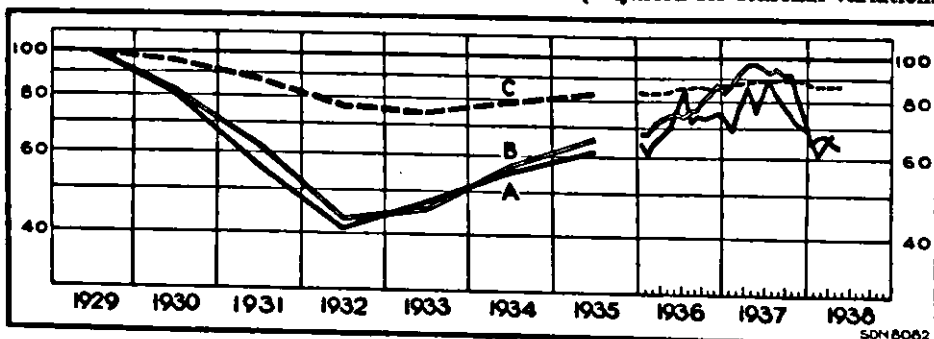
Indices of Cash Farm Income, Pay-rolls and Cost of Living in the United States.

(1929 = 100.)

A Cash farm income. B Pay-rolls. C Cost of living.

(Logarithmic scale.)

(Adjusted for seasonal variations.)



¹ Cf. Chapter V for a more detailed consideration of the changes in interest rates.

But although there had been a more rapid fall and rise in the production of investment goods between 1929 and 1937, the following figures show that, in 1937, the production of consumption goods had more nearly regained the 1929 level than the production of investment goods.

	1929	1932	1937
Production of investment goods	100	28	89
Production of consumption goods	100	76	95

The recovery of consumers' incomes is illustrated in the second graph by cash farm income and pay-rolls, which represent the money incomes of farmers and of industrial workers. In the same graph, the cost of living is shown. It can be seen that pay-rolls had overtaken the cost of living by 1937, so that the real purchasing power of industrial wage-earners was higher than in 1929. At the same time, farmers' income had recovered well, and in real terms was also practically as great as in 1929. This recovery in consumers' purchases is shown by department store sales on the first of the two graphs. After making allowance for the fall in prices, such sales had probably reached their pre-depression level by 1937.

The figures for the production of investment goods and of consumption goods show that the recent recession was marked by a rapid fall in investment activity with a very much smaller fall in the production of consumption goods. Between August and December 1937, the production of investment goods fell by 51.7% while the production of consumption goods fell only by 13.3%. In the same period, steel output fell by 69.7%, motor-car production (after making allowance for seasonal variations) by 50.3%, and the value of contracts awarded for residential building plans by 25%. On the other hand, pay-rolls showed little tendency to fall until November, and between August and December fell by 22%; and department store sales (after making allowance for seasonal variations) also were maintained at a practically constant level until November, falling between August and December only by 3.3%. These figures leave little doubt that the immediate cause of the recession was an abrupt fall in investment activity and in expenditure on durable consumption goods such as motor-cars, and that it was only the consequent fall in incomes which later caused a reduction in expenditure for current consumption.

Many explanations have been offered for this abrupt fall in investment. These explanations are usually in no way contradictory, and it is probable that the recession in investment was due to a conjunction of many unfavourable factors, only the most important of which can be discussed here. According to

one theory,¹ which is well illustrated by these recent events in the United States, the level of investment activity depends upon the rate at which the demand for consumption goods is expanding. When the demand for consumption goods is expanding rapidly, investment activity will be high in order to provide the new capital instruments with which the greater output of consumption goods may be produced. On the other hand, the production of capital instruments will soon fall to a low level if the demand for consumption goods ceases to increase, even though this demand remains at a high level; for new capital instruments are needed only when the output of consumption goods is increasing. From the first of the two graphs on page 14, it can be seen that department store sales, which may be taken as an index of the demand for consumption goods, started to rise in 1933. After a relatively rapid rise during 1936, the expansion of consumers' demand ceased, and department store sales remained remarkably stable for twelve months after November 1936. By August 1937, this remarkable stability of consumers' demand had continued for some nine months; and this would have given time for producers to appreciate the fact that consumer's demands had ceased to expand and for existing orders for capital construction to have been completed. In consequence, at this point, investment activity, as represented by the index of production of investment goods, reached its peak and subsequently fell off abruptly.

It remains, however, to explain why consumers' demands ceased to expand at a time when the recovery might be thought not fully to have run its course. It is not difficult to find certain definite factors which may have caused a rapid expansion of consumers' demand in 1936 and a subsequent failure of further expansion in 1937. In the first place, in January 1936, the Veterans' Bonus Act was passed, which enabled the veterans of past wars to claim immediately in cash the payment of the full face value of their pension rights. Some 3,500,000 veterans were to receive nearly \$2,500 million worth of bonds, which could be cashed on demand; and the following table shows the effect of this measure on the Government's expenditure on pensions. When it is remembered that the whole American national income for 1936 was approximately \$63,800 million,² it is clear that there may have been a very appreciable expansion in consumption during 1936 due to this particular cash bonus. Since this bonus payment was not repeated, the increase

¹ This theory has recently been developed by Mr. R. F. HARROD in *The Trade Cycle: An Essay*.

² The National Industrial Conference Board estimates that the national income for 1937 will amount to \$67,500 million.

in consumption which was caused by it was one which could not be expected to last for long.

Actual Expenditures of the United States Government on Veterans' Pensions and Benefits for Fiscal Years:

\$ (000,000's).

1931/32	1932/33	1933/34	1934/35	1935/36	1936/37	1937/38 (Estimates)
973	849	554	606	2,349	1,128	574

In 1936, the tax on the undistributed profits of corporations was introduced; and this tax, by imposing a special burden on that part of business profits which was retained in the business, had the effect of increasing the proportion of profit which was paid out to individuals in dividends. The following figures show that, as normally happens with recovery in

Profit earned and Dividend paid by Certain Companies as Percentage of Their Invested Capital.¹

	Net profit earned	Dividend paid	Dividend as % of profit
1929.	20.7	14.1	68.1
1930.	13.4	11.6	86.6
1931.	9.8	11.6	118.4
1932.	2.9	6.9	237.9
1933.	8.2	6.4	78.0
1934.	9.3	7.5	80.1
1935.	13.7	8.9	65.0
1936.	18.3	14.6	79.8

business profits, the ratio of dividend payments to profit earnings tended to fall between 1932 and 1935; but, in 1936, this trend was abruptly altered, for the effect of the undistributed profits tax which was first imposed that year was to decrease the proportion of profits retained in the business, and thereby to stimulate expenditure on consumption. The proportion of profits paid out in dividends may have been raised permanently to a higher level by this tax, and this might cause an expansion of consumption which would later be stabilised at the higher level. This tax may, then, in part explain the rapid expansion of consumption in 1936 and its stabilisation at a higher level in 1937.

¹ *Monatsberichte des Oesterreichischen Institutes für Konjunkturforschung, December 1937.*

In 1936 and 1937, the Federal Government and the States began to raise taxes mainly for the future finance of old-age pensions and of unemployment benefits.¹ Pay-roll taxes on employers, together with taxes on workers' wages, were levied during 1937 for these purposes, although the main benefits were not to be paid out until later. Part of the proceeds of these taxes were paid to the Federal Treasury to be invested in special obligations of the Federal Government. In effect, the borrowing made necessary by the nominal budget deficit of the Federal Government was covered by these special taxes. For example, on January 5th, 1938, the net deficit in the Federal Budget for 1937/38 (exclusive of expenditure on debt retirement) was estimated at \$1,088 million, against which there were trust funds of \$1,194 million available for investment in the special obligations of the Federal Government. The corresponding figures, estimated at the same time, for the budget of 1938/39 were: net deficit \$950 million, against which were trust funds of \$1,163 million available for investment in Government obligations. These figures may be compared with a net budget deficit of \$4,361 million in the year 1935/36.² The following figures show that over \$1,200 million were levied in social security taxes during the calendar year 1937, without any corresponding expenditure on old-age and unemployment bene-

*Combined Receipts of U.S.A. Treasury of Direct Taxes for Old-age Benefits and Railroad Retirement, and of Unemployment Trust Funds remitted by States.**

	\$ (000,000's).	
	1936	1937
Old age	—	592
Railroad retirement	—	68
Unemployment insurance	65	568
Total	65	1,228

fits. This taxation, by withdrawing income from the employer and the wage-earner in the absence of any corresponding payment of benefits, may have had a marked effect in putting a stop to the expansion in expenditure which might otherwise have continued during 1937.

Rising prices on the stock exchange during 1936 and the subsequent stock-exchange depression may well have intensified

¹ Other aspects of this social security legislation are discussed in Chapter II.
² It is estimated that, by 1930, \$47,000 million will have been accumulated for investment in obligations of the Federal Government on behalf of the old-age reserve account, although the total debt of the Federal Government was no more than \$36,427 million at the end of 1937.

³ Cf. *National City Bank of New York*; letter of January 1938.

this tendency for consumers' expenditure to rise rapidly during 1936 and then to remain stable during 1937. It will be seen

*Market Value of All Shares listed on the New York
Stock Exchange.*

§ (000,000's).

Monthly average, 1935	37,900
January 1936	50,200
January 1937	61,900
July 1937	59,400
January 1938	39,200

from the above figures that the capital value of all securities listed on the New York stock exchange rose by \$11,700 million during 1936, fell by the comparatively moderate sum of \$2,500 million during the first half of 1937 and by as much as \$20,200 million during the second half of 1937. Such large capital gains and losses, while they may not directly affect the incomes of the owners of these securities, certainly affect their readiness to spend money on consumption. This is perhaps more particularly true in the United States of America, in which speculation on the stock exchange is a widespread practice and in which capital gains obtained from the purchase and sale of securities are treated for tax purposes as income.

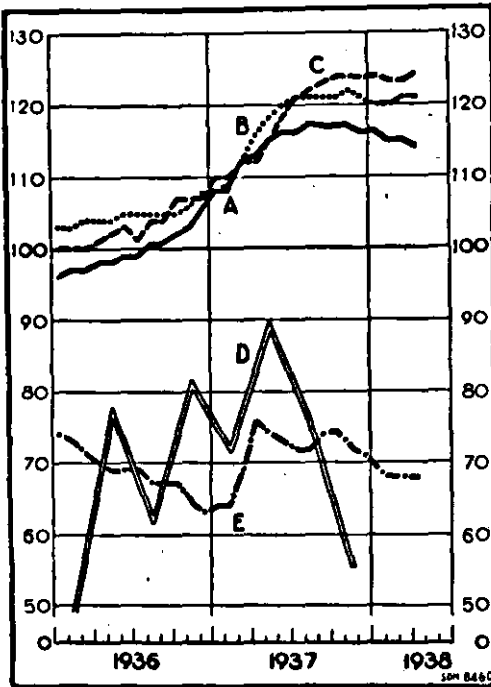
The failure of consumption expenditure to expand further after 1936 may have been one of the most important causes of the marked decline in investment which started in the autumn of 1937; but there were probably many other influences at work. Private investment activity — *i.e.*, expenditure by business-men on machinery and plant for the development of their capital equipment — is dependent upon three main factors; it is influenced primarily by the prospect of working the new equipment at a profit, but it is also stimulated by low costs of construction of the new equipment and by easy conditions for obtaining the necessary funds for the finance of the capital development. The following graph illustrates the operation of these factors in the United States during 1936 and 1937.

It will be seen that industrial profits reached their peak in the second quarter of 1937, when they were still 10% below the 1929 level. As profits ceased rising and started to decline in the middle of 1937, it is probable that the expectation of profits changed adversely at the same time and that this reacted adversely on investment activity. One reason for this

Profits, Construction Costs and Interest-rate in the U.S.A.

(1929 = 100.)

- A Construction costs.
- B Hourly earnings (all factory labour).
- C Hourly wage-rates (common construction labour).
- D Industrial profits.
- E Long-term interest rate.



change in the prospect of profits — namely, the failure of the demand for consumption goods to continue to increase after 1936 — has already been discussed at length; but another important reason is illustrated by the curve of wages shown in the graph on this page. During 1936, hourly wages were fairly stable at a figure approximately 5% above the 1929 level; but, towards the end of 1936 and during the first half of 1937, they rose rapidly until they were 20% above the 1929 level. Unless it is accompanied by a corresponding increase in the price offered for the commodity produced, a rise in wage costs lowers profit margins; this not only diminishes the production of the commodity directly affected, but, by reducing profit expectations, reacts adversely on the demand for equipment for capital extensions. The sharp increase in wage-rates in the first half of 1937 prob-

ably reacted adversely on investment activity in this way.

The prospect of further increases in wage-costs probably also discouraged capital extensions. Frequent labour demands, often backed by strike measures, had been experienced for many months. The Black-Connery Wages and Hours Bill, by which the Administration hoped to obtain a minimum wage of 40 cents an hour and a maximum working-week of 40 hours for every industrial worker, was passed by the Senate in July 1937, although it was subsequently shelved until June 1938. Under the Social Security Legislation, the employers were faced with new taxes for social-insurance purposes, amounting in 1937 to 2% of their payrolls for unemployment insurance and 1% of their payrolls for old-age pensions, and rising in all to 6% of their payrolls by 1949.

Many public utility undertakings, at the same time that their costs were rising, felt a growing uncertainty as to the

profitability of any investment undertaken by them in view of the possibility of extended Government competition with them. Moreover, business-men argued that the Government's attitude towards big trusts in general and holding companies in particular was too uncertain to justify extensive schemes of long-term investment. In the opinion of many, the uneasy relations between business and the Administration were the main cause of the failure of investment activity.

A rise in the cost of capital goods is a second factor that discourages investment. No comprehensive index of the price of capital goods appears to be available; but the curve of construction costs in the graph on page 20 illustrates the movement of costs in one of the important industries producing goods for capital investment. This curve rose sharply during the last quarter of 1936 and the first half of 1937. Higher wage-rates for labour engaged in the industries producing capital goods are liable to discourage capital extensions directly by raising their cost. The rise in the hourly wage-rates of construction labour,¹ illustrated in the graph on page 20, has played an important part in determining the rise in construction costs.

The third main factor that discourages capital extensions is an increased difficulty in obtaining the necessary funds. The sterilisation of gold imports and the raising of the reserve requirements of the member banks by the Federal Reserve Board in March and May 1937 had some effect in restricting the supply of credit; and while short-term rates of interest continued at very low levels, there was an appreciable rise in the long-term rate of interest early in 1937, as can be seen from the graph on page 20. The importance of these monetary measures in restricting investment activity will be considered at greater length in Chapter V. At the same time, the financing of capital extensions was rendered difficult by the law regarding capital issues and by the heavy tax on undistributed profits imposed in 1936, which made it more difficult for businesses to finance new investment out of any profits which were still put to reserve in the business.

Apart from these factors affecting private investment, public expenditure was reduced by the measures taken by the Federal Government to balance the budget. The following figures show that the budget deficit reached its maximum in the year ending June 1936, and that, since then, strenuous measures have been taken to reduce expenditure and to increase revenue. As already pointed out, the change in the

¹ The graph on page 20 shows that the wages of construction labour and of factory labour in general have followed each other very closely during 1936 and 1937, and bear much the same relation to each other as they did in 1929.

budgetary position is even more marked if account is taken of the financial effects of the Social Security Legislation.

Government Receipts and Expenditure.

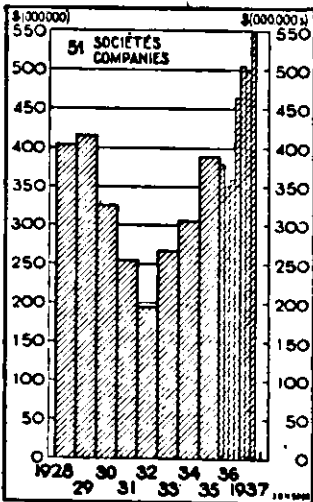
\$ (000,000's).

	1934/35	1935/36	1936/37	1937/38 Estimate of January 1938*
Total receipts	3,800	4,116	5,294	6,321
Total expenditure exclud- ing debt retirement . .	6,802	8,477	8,001	7,409
Net deficit	3,002	4,361	2,707	1,088

* Since this estimate was announced, certain additional expenditures have been incurred or proposed for naval rearmament and, as a result of the recession, for relief and public works. These measures are discussed in Chapter IX, where revised figures of the budget deficit for 1937/38 and an estimate of the budget deficit for 1938/39, are given.

In the first months of the recession, it was commonly asserted that, during the end of 1936 and the beginning of 1937, American businesses had increased their stocks too heavily in an over-optimistic estimation of the extent to which demand

Company Inventories in the United States.



would expand and that attempts to liquidate these excessive stocks had led to the postponement of new orders and so to the inception of the recession. The accompanying diagram shows the inventories of a sample of fifty-one companies. The height of each column for the years 1928 to 1935 represents the inventories of these companies at the end of each year. For 1936 and 1937, the inventories are shown for each quarter of the year. "The increases in the inventories of the fifty-one corporations in the autumn of 1936 were notably rapid. By the end of that year, inventories were about 13% greater than they had been at the end of 1929. Since wholesale prices were some 21% lower, the physical volume of

inventories may have been as much as 35 to 40% greater at the end of 1936 than they were at the close of 1929. Then, by the third quarter of 1937, there was a further increase of about 18%." ¹ It is clear that the over-optimistic building-up of inventories during the end of 1936 and the beginning of 1937 may have

¹ This quotation and the accompanying diagram are taken from the *Cleveland Trust Company Business Bulletin* of January 15th, 1938.

played an important rôle in the subsequent recession by causing a sharp reduction in companies' purchases in order to sell off their excessive stocks.

To meet the recession, certain measures have already been taken since the middle of 1937. By reducing discount rates, by open-market purchases of securities, by relaxing the rules for the eligibility of paper for discount with the Reserve Banks, and by reversing the policy of sterilising imported gold, the monetary authorities have adopted the traditional policy of easing credit conditions in times of depression.¹ Further, the Federal Reserve Board has relaxed the margin requirements for speculation on the stock exchange. In March 1936, the proportion of the value of any purchases on the stock exchange which the buyer himself had to contribute in cash without borrowing, had been raised to 55%, in order to prevent undesirable "bull" speculation. This measure, by keeping some potential purchasers out of the market, tended to depress security prices; in consequence, the margin was reduced to 40% in November 1937. The fall in security prices in the last half of 1937 was, of course, in the main merely a reflection of the less favourable prospects of business, as doubts were felt, first, as to the expansion and, later, as to the maintenance of business profits. But to some extent the stock-exchange slump may have been intensified, not only by the requirements of a high cash margin for speculative purchases, but also by the capital gains tax; for this tax, by imposing a levy on profits made through the purchase and subsequent sale of securities, naturally discouraged "bull" speculators from making purchases as soon as they considered that securities were undervalued.

By the Housing Act passed in February 1938, the Government has taken steps to stimulate investment in housing, which, as the following figures show, has far to go to reach its 1929 level and which is also one of the most important industries from the point of view of investment activity. By

*Value of Contracts awarded for Residential Buildings
in the United States.*

(1929 = 100.)

1934	1935	1936	1937
13	25	42	47

this Act, the Federal Housing Authority is empowered to insure private loans up to 90% instead of, as previously, 80% of the capital invested in a dwelling-house, and the charges for such insurance are reduced. At the same time, the insurable limits

¹ Cf. Chapter V.

of the value of the houses to be constructed have been raised in such a way that the speculative building of blocks of dwellings is encouraged. President Roosevelt has, at the same time, conducted a campaign for the reduction of building-costs. Finally, the rearmament programme of naval construction, introduced by the President's message to Congress of January 28th, 1938, contemplates a 20% increase in the existing building programme for increases and replacements in the navy and involves an additional expenditure of somewhat less than \$40 million in the financial year 1938/39. This measure also will directly stimulate the demand for capital goods.¹

The recession has up to date been rapid and severe; but there is at least one feature which is calculated to reduce its severity and to make it easier to devise measures to cure it. The United States has larger accumulated needs in durable goods now than she had in 1929. It will therefore become increasingly difficult to postpone investment expenditure and increasingly easy to find useful forms of capital expenditure to stimulate recovery. In this way, the position is undoubtedly less threatening than it was in 1929. An estimate made by the Brookings Institution² suggests that, in order that each member of the community should, by 1941, be as well equipped as he was in 1929, an annual expenditure on durable goods of \$32,800 million (at 1936 prices) would be necessary, as compared with an actual expenditure of \$21,000 million during 1936. There is at least no lack, it appears, of useful works of capital development in the United States.

¹ Later measures of the same nature are discussed in Chapters V and IX.

² The following table has been borrowed from *The Recovery Problem in the United States*, published by the Brookings Institution.

Durable Goods Requirements, 1937-1941, compared with Production in 1936.
U.S. \$ of 1936 (000,000,000's).

Class of Goods	Deficiency at end of 1936	Regular requirements 1937-1941	Average annual production 1937-1941 necessary to meet both deficiency and regular requirements	Production in 1936
Residences (non-farm)	9.0	11.3	4.1	1.3
Passenger automobiles	2.2	12.8	3.0	2.6
Other consumers' durable goods	1.0	29.0	6.0	4.5
Steam railroads	2.3	10.0	2.5	1.5
Public utilities		11.0	2.2	1.3
Industrial enterprises	11.0	40.0	10.2	6.0
Agriculture	1.5	5.0	1.3	0.8
Public and semi-public construction		17.5	3.5	3.0
Total	27.0	136.6	32.8	21.0

This estimate allows for sufficient construction to meet both the depreciation of capital and the growth of population since 1929, but not for any improvement of standards over those of that year.

FRANCE

It is interesting to compare the recent economic experience of the United States of America with that of France; for there are certain surprising similarities between the two countries, whose experiences have in other ways been very different. Both countries — in the “new deal” of President Roosevelt and in the experiments of M. Blum — have in recent years adopted far-reaching social and economic policies, which combined recovery measures with measures of social reform. In both cases, the recovery measures have aimed at raising money incomes, in order to increase production and employment through the increased demand for goods and services; but, in both cases, this policy has to a large extent taken the particular form of raising money wage-rates and reducing hours of work. In each case, it has been accompanied by expenditure on public works and by other similar measures. The early raising of money wage-rates has caused many producers to complain of increased costs. The consequent doubt regarding the prospects of profit and the uneasy relations between business-men and the Government have, in the opinion of many, been an important factor in delaying recovery. In France, unlike the United States, this lack of confidence combined with a persistent expectation of depreciation of the franc has led to a flight of capital from the country, which has continued even after the devaluations of September 1936 and July 1937.

Both France and the United States, unlike the United Kingdom and Germany, have for various reasons failed to regain the 1929 level of employment and production; but, on the other hand, there have been very marked differences in the timing and extent of the last depression and recovery in the two countries, as can be seen from the graphs on page 10. Employment and production never fell nearly as low in France during the post-1929 depression as they did in the United States. In the United States, they reached their lowest level in 1932, and then recovered substantially until the recession in the autumn of 1937. But in France, which adhered to the old gold parity of the franc until September 1936 and adopted a policy of deflation, employment and production continued to decline until the autumn of 1936, when the franc was devalued. Recovery since then has been hesitant and uncertain.

An examination of the graph on page 10 shows two other marked features in the recent economic experience of France: the failure of interest rates to fall since 1929 and the remarkable

rise in prices and money wage-rates during 1936 and 1937. In the United Kingdom and the United States, the yields on long-term Government stocks, in spite of some rise in the early part of 1937, remained some 25% lower than in 1929. In France, on the other hand, the yield on Government stocks was higher than in 1929. The long-term rate of interest fell in France directly after 1929, while the country was still in a strong financial position; and during these early years of the slump, business activity was maintained better in France than in the United Kingdom or the United States. But, after the abandonment of the gold standard, by the former in 1931, and by the latter in 1933, pressure was exerted on the franc; France's internal monetary conditions became strained, and interest rates rose to the high levels at which they have subsequently remained with minor variations. Even after the devaluation of the franc, the export of capital from France continued and no marked or permanent fall in the rate of interest occurred; and in this respect the experience of France differs from that of other countries which have devaluated their currencies, as is made clear from the figures given in Chapter V.

The second remarkable feature in the graph on page 10 is the rapid rise in hourly money wage-rates, which was the result, not of an increased demand for labour in a period of full employment, but of definite acts of social policy adopted during a depression in order to raise purchasing power. This sudden increase in money wage-rates offset those effects of devaluation which might have contributed a stimulus to production. For devaluation — or indeed any method of expanding production and employment by increasing the money demand for commodities — will stimulate production only if the rise in the prices offered for commodities is not fully offset by increased costs. In fact, as can be seen from the graph, prices and wage-rates both rose rapidly in approximately the same proportion during 1936 and 1937, so that there was no appreciable stimulus to increased production.

This rise in prices and wage-rates has, moreover, been one of the main causes of the continuation of strained foreign exchanges and of high interest rates after the devaluation of the franc. A rise in prices and costs tends to contract exports and to stimulate imports; and the French balance of trade has for this reason become progressively more unfavourable.¹ This has intensified the drain on the gold reserves; it has necessitated successive devaluations of the franc; and, by strengthening the expectation of such devaluations, has inten-

¹ Cf. Chapter VI.

sified the flight of capital abroad. The consequent drain on the gold reserves, by preventing any expansion of the internal supply of money, has been one of the causes keeping interest rates at a high level. At the same time, the rise in prices and wage-rates has directly increased the demand for money, since a larger circulation is required to finance the same volume of transactions at a higher level of money prices and costs;¹ and this increased demand for funds has hindered the application of a cheap-money policy in France.

If the rise in money wage-rates and so in labour costs had taken place without a simultaneous rise in prices, there would doubtless have been a considerable diminution in employment and production. This result was avoided by heavy Government expenditure; for the extension of the forty-hour week and the rises in wage-rates took place at a time when the demand for goods and services by the French Government was inflated by public works and rearmament. In spite of increased taxation imposed by the Decree Law of July 1937, which was estimated to bring in an additional 2,800 million francs during the second half of the year, the budget for 1937 closed with a deficit estimated at 7,000 millions; but this deficit constituted only a small part of the total true deficit, which should include the Treasury borrowings for such purposes as the finance of the railway deficits, and special expenditures on public works and rearmament. It is estimated that the national debt rose by as much as 42,000 million francs in the course of 1937. As normal receipts in 1937 were 44,000 million francs, it appears that nearly half of the total Government expenses were met by borrowing.² Borrowing on this scale could not all be met by issues of new stock to the market, and the Treasury was forced to borrow more than 14,000 million francs from the Bank of France, as the following figures of the Bank of France's advances to the Treasury show:

December 30th, 1936	20,898 million francs.
June 24th, 1937	27,126 " "
December 30th, 1937	35,108 " "

The magnitude of this budgetary problem, and the effect which such borrowing must have had in stimulating demand and raising prices, can be realised when it is compared with

¹ This point is illustrated in the graph on page 10 by the index of bank clearings, which has risen since the middle of 1936 in spite of the fact that production and employment have failed to rise appreciably.

² Cf. *L'Activité économique*, January 1938.

the estimate of some 200,000 million francs for the annual national income of France quoted by M. Marchandau in January 1938. If this estimate is not too low, total Government borrowing during 1937 was as much as 20% of the national income.

Every effort was made in July 1937 to set a limit to the deficit by restraining any further increase in expenditure and by imposing fresh taxation. In the budget approved for 1938, receipts estimated at 54,776 million francs were slightly in excess of estimated expenditure; and total borrowings for 1938 were estimated¹ at 27,500 million francs, including:

Defence	11,300	million francs.
Public works	3,300	” ”
Pensions	2,300	” ”
Posts, railways, colonies, etc.	9,000	” ”

These estimates do not include any allowance for additional expenditure which may be voted in the course of 1938.²

Throughout 1937 and the early weeks of 1938, the position of the franc in the foreign exchange market was a source of anxiety, being in part a cause and in part an effect of the failure of employment and production to improve. The internal rise in prices and costs, together with the necessity for borrowing by the Treasury on a vast scale, gave rise to the expectation of further depreciation of the exchange value of the franc and so to a flight of capital abroad. This flight of capital not only intensified the exchange weakness of the franc, but, by putting a strain on the gold reserves of the Bank of France, also led to monetary pressure. This monetary pressure in turn, by preventing any considerable reduction in long-term rates of interest, checked the recovery of internal production and employment. Apart from the effect of social legislation, such as the imposition of the forty-hour week, which will be discussed in Chapter II, the problem of the exchange value of the franc dominated the French economy during 1937.

THE UNITED KINGDOM

In the United Kingdom, as can be seen from the graph on page 11, employment and industrial production fell by a relatively moderate amount during the depression after 1929. Moreover, there was little fall in either of these indices after

¹ Cf. *Bulletin Quotidien*, December 17th, 1937.

² An additional sum of 3,200 million francs for national defence was proposed by the Cabinet on February 22nd, 1938.

1931; and from 1932 recovery continued until the middle of 1937, when industrial production and employment reached figures 25% and 15% higher than their average level in 1929. In fact, by the middle of 1937, the unemployment caused by the depression had probably disappeared; the normal turnover of labour in the prosperous trades, together with the difficulties peculiar to the "distressed areas" and to the declining trades, would seem to explain all the unemployment that remained. It has been estimated¹ that normal short-period unemployment in the United Kingdom accounts for between 6 and 8% of the total number of workers insured against unemployment, and that unemployment due to structural changes in industry accounts for another 4%, so that, until alternative occupations have been found for those previously engaged in the declining industries, the unemployment of between 10 and 12% of the insured workers may remain after the disappearance of all "trade cycle" influences. From August to October 1937, the percentage of workers unemployed in Great Britain was below 10%, after having been as high as 23% in 1931. In consequence of this relative shortage of labour, the index of money wages, which had shown a remarkable stability since 1929, rose somewhat in 1936 and 1937.

In comparison with the United States, the United Kingdom had by 1937 reached a much more advanced stage of recovery, and during 1937 experienced much less violent fluctuations; but the sequence of events was in many ways similar in the two countries. In both, the long-term rate of interest hardened appreciably in the first quarter of the year; security prices reached their peak at the turn of the year 1936/37, and fell throughout 1937, though there was a temporary recovery at the end of the second quarter; employment and wholesale prices reached their peak towards the middle of 1937 and thereafter declined consistently.

The rise in long-term interest rates in the United Kingdom at the beginning of 1937 was in large measure due to the expectation of greater pressure on the capital market following the announcement in February of the Government's decision to spend £1,500 million on rearmament in the course of the next five years, and to finance £400 million of this sum by means of borrowing. This announcement of large-scale Government borrowing came at a time when the rapidly rising activity of trade was causing private businesses to make increasing claims for funds; and, as will be seen in Chapter V, the commercial banks were obliged during 1937 to reduce their invest-

¹ Sir William BEVERIDGE: "An Analysis of Unemployment", *Economica*, May 1937.

ments in securities in order to lend more in advances to customers. The hardening of interest rates, it has been argued,¹ was also caused by the increased demand for liquid funds on the part of foreigners who were importing funds into the United Kingdom; for the imported gold was not permitted to cause an increase in the supply of money, but was purchased by the Exchange Equalisation Fund with money raised indirectly through the sale of long-term securities on the capital market. This sale of securities drained funds from the market to meet the increased demand for money for hoarding purposes on the part of the foreign sellers of gold; and this maintained interest rates at higher levels. This combination of circumstances caused the yield on long-term Government securities to rise appreciably early in the year, although short-term interest rates continued at very low figures.

Heavy rearmament expenditure might have been expected to increase the total demand for goods and services and so to stimulate industrial profits; but, in fact, industrial share prices fell throughout 1937, so that it would appear that investors expected some fall in profits. There were, however two special factors influencing the price of ordinary shares. In the first place, the rise in long-term interest rates on Government securities in the early part of 1937 made it necessary to adjust ordinary share prices in a downward direction in order to bring the yield on them into line with the yield on fixed interest securities. Secondly, in April 1937, the Government announced its intention to impose a special tax, known as the National Defence Contribution, on the growth of company profits above a standard level. This tax was widely criticised on the grounds that, in taxing growing profits, it imposed a special burden on initiative and enterprise and on companies which were most subject to cyclical fluctuations, and that the whole levy fell on variable dividends as opposed to fixed incomes. In June, the tax was revised to take the form of a flat-rate levy of 5% on companies' profits. Although the tax was no longer a special burden on growing profits, it was still one which fell on incomes from dividends as opposed to fixed incomes, and it thus caused a reduction in the value of industrial shares. The further fall of share prices during the second half of the year can be ascribed, first, to reactions due to the stock exchange slump in the United States of America, and, later, to the increased uncertainty of the business outlook, as commodity prices and employment fell in the United Kingdom itself.

¹ J. M. KEYNES: Speech to National Mutual Life Assurance Society, reported in *The Times*, February 24th, 1938. For a fuller discussion of this point, cf. Chapter V.

Economic prospects in the United Kingdom at the beginning of 1938 were dependent upon the answers to three questions: To what extent would the world demand for United Kingdom exports be affected by the recession in other countries? To what extent would private investment in capital goods continue at a high level? To what extent would Government expenditure, and in particular expenditure on rearmament, prevent any appreciable fall in business activity? The accompanying graph shows monthly changes since 1935 in the value of United Kingdom exports, in the consumption of iron and steel, and in building plans passed for all purposes by 146 local authorities. It is clear that the demand for United Kingdom exports has shown a falling trend since the autumn of 1937. Building activity and the consumption of iron and steel may be taken as representative indices of investment activity; while building is predominantly for civil purposes, iron and steel consumption is to a large extent affected by the rearmament programme.

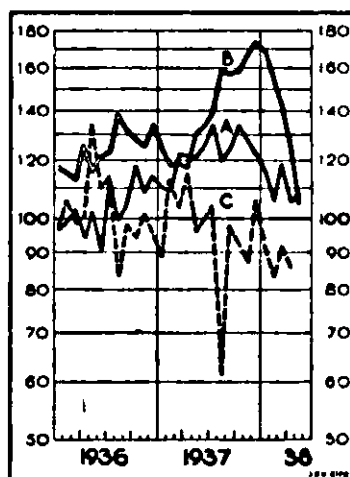
As the following estimates¹ show, house-building has recently formed an unusually large part of total investment in the United Kingdom. It can, however, be seen from the graph

Exports and Investment Activity in the United Kingdom.

(1935 = 100.)

- A Exports.
- B Iron and steel consumption.
- C Value of building plans passed.

(Logarithmic scale.)



£ (000,000's).

	1929	1934	1935
Total net home investment in fixed capital	255	228	268
Of which expenditure on houses.	85	131	145
Expenditure on houses as a percentage of the total	33.3%	57.5%	54.1%

that building activity was lower in 1937 than in 1936; and although it has been maintained surprisingly well since the

¹ C. G. CLARK: *National Income and Outlay*, page 193.

recession in business activity in the autumn of 1937, the private constructional boom has probably reached its peak and some further decline is to be expected, unless State and municipal building takes the place of private construction.

The great increase in the consumption of iron and steel shown on the graph during 1937 marks the process of rearmament expenditure; but this index appears to have reached its peak towards the end of 1937, which suggests that the rise in expenditure on rearmament was no longer sufficient fully to offset the decline in private investment. In considering the effect of rearmament expenditure upon constructional activity in the United Kingdom, two periods must be distinguished: first, the period during which private firms have been extending their capital equipment sufficiently to meet the increased Government orders; and, secondly, the remaining period of high Government orders, during which no further capital extensions by private business are required. Even though Government expenditure on rearmament has not yet reached its peak, the total investment activity induced by rearmament may fall off as soon as private firms have expanded sufficiently to meet the increased Government demands.

The following table gives figures for expenditure on rearmament, for total Government expenditure, and for total revenue of the United Kingdom for recent years.

£ (000,000's).

	1928/29	1935/36	1936/37	1937/38	1938/39 Esti- mates
Expenditure on defence ^a . . .	113.5	136.9	186.1	262.1	343.2
Total expenditure ^b	760.5	829.4	889.1	974.2	1,104.3
Total revenue	836.4	844.8	896.6	948.7	1,025.2
Revenue surplus (+) or deficit (-)	+75.9	+15.4	+ 7.5	-25.5	-79.1

^a Including expenditure financed by borrowing.

^b Including expenditure on defence financed by borrowing and excluding expenditure on debt redemption which is assumed to be the same for 1938/39 as it was during 1937/38.

Expenditure on defence is estimated to be £206.3 million greater in the financial year 1938/39 than in 1935/36. The importance of this increase can be realised when it is compared with estimates of £305 million for total investment and of £4,530 million for the total national income in 1935.¹

¹ CLARK, *op. cit.*

As the above table shows, a considerable part of the increase in expenditure on armament has been covered by means of increased revenue, so that the actual borrowing made necessary by rearmament is represented by the change from a true budget surplus of £15.4 million in 1935/36 to an estimated deficit of £79.1 million in 1938/39.¹

GERMANY

In Germany, as can be seen from the graphs on page 11, the fall in trade activity between 1929 and 1932 had been much more violent than in the United Kingdom; but, as in the United Kingdom, complete recovery of employment and production had been achieved by 1937. The following figures illustrate the depth of the depression and the height of the recovery in the two countries:

	Germany			United Kingdom		
	1929	1932	1937	1929	1932	1937
Index of employment . .	100	71.1	104.3	100	91.7	112.4
Registered unemployed (thousands)	1,892	5,575	912	1,263	2,568	1,482
Index of industrial produc- tion	100	53.3	117.2	100	83.5	124.0
Index of real wage-rates .	100	104	98	100	110	110

It will be seen that, both in employment and in production, the fall between 1929 and 1932, and the rise between 1932 and 1937, were much more rapid in Germany than in the United Kingdom. By 1937, both countries had recovered to levels above those of 1929; but, in spite of rapid recovery since 1932, German employment and production had not reached such high levels as in the United Kingdom. As can be seen from the graph on page 11, money wage-rates in Germany remained at slightly less than 80% of their 1929 level,

¹ The actual deficit in 1937/38 was £25.5 million, so that the issue in April 1937 of £100 million of National Defence Bonds was in excess of the requirements of new money during the whole financial year and enabled the Government to reduce its borrowing by means of Treasury Bill issues.

with the result that, in spite of the fall in the cost of living, the real wage-rates in 1937 were slightly below the 1929 level.

The number of unemployed workers in Germany fell from an average of 5,575,000 in 1932 to the quite nominal figure of 469,000 in September 1937, and there exists in Germany a real shortage of labour, which will be discussed in greater detail in Chapter II. This fall in unemployment may be ascribed to the simultaneous operation of two factors. The demand for labour, which is illustrated by the index of employment, has increased rapidly and considerably since 1933. But it is doubtful whether this recovery alone is sufficient to explain the very low figures of unemployment; for between 1929 and 1937 the average number of insured workers in employment rose by 907,000 (from 17,595,000 to 18,402,000), while the number of registered unemployed fell by 980,000 (from 1,892,000 to 912,000). The increase in employment would therefore have been insufficient to account for the fall in unemployment, even if there had been no increase in the population of working-age during the intervening years. When allowance is made for such a normal increase in the numbers seeking work, the very low level of unemployment in 1937 must be partly explained by the drain of man power into the armed forces and into such organisations as the labour corps, whose members are numbered neither among the employed nor among the unemployed.

Throughout 1936 and 1937, money expenditure on goods and services increased rapidly, as can be seen from the index of bank transfers in the graph on page 11; but, in spite of this increase in money demand and in spite of a much reduced reserve of labour, the index of money wage-rates has remained unchanged, and the index of wholesale prices has shown practically no rise. It has been the express policy of the Government to keep hourly money wage-rates fixed at their 1933 level and to prevent fluctuations in commodity prices. The enforcement of this policy was strengthened in October 1936 by the appointment of a Price Commissioner, who at first prohibited all price increases, and later permitted higher prices to meet higher costs and decreed price reductions where this was possible. There have, in fact, been many changes in the price of individual commodities, while the general level of prices has remained remarkably stable.¹

As the graph on page 11 shows, the American recession caused no marked setback in Germany in 1937, except in the

¹ In some cases, the stabilisation of prices in spite of rising demand has made rationing necessary. For example, supplies of iron and steel have since May 1937 been allotted by quotas in order of preference for different uses — rearmament, machine construction, mining, shipbuilding, boilermaking, motor manufacture and house-building.

case of security prices, which fell in sympathy with the slump in prices in the United States.¹

The recovery of economic activity was accompanied by great investment activity, as the following figures show:

Indices of German Industrial Production.

	1929	1932	1937
Investment goods	100	34.4	124.4
Consumption goods	100	76.3	104.6

This remarkably high level of investment activity appears to have been maintained by the same measures by which it was achieved — namely, by heavy Governmental expenditure on rearmament and public works, including the development of the new system of motor-roads, of canals and of industrial equipment. As no budgetary figures of expenditure are published, it is not possible to estimate the importance of Government expenditure on armament and on other objects. But the following estimates² show clearly the increasing importance of public expenditure in investment activity.

Capital Construction in Germany: New Investment plus Replacements.

RM. (000,000's).

	1928	1932	1936	1937
Public works, including transport, canals and roads . .	4,590	1,705	7,600	...
Other.	9,085	2,520	6,200	...
Total	13,675	4,225	13,800	15,500 to 16,500

The high level of Government expenditure has been in part offset by the fall in expenditure on unemployment relief, and in part financed by increased revenue due both to higher rates of taxation and to the improvement of the yield of existing taxes, and by borrowing first through the issue of special short-term bills and then through long-term issues to consolidate this short-term debt. The following figures² illustrate the importance to the Reich and local government authorities of the sums made

¹ The fall in employment since the summer of 1937 appears to be no more than a seasonal movement.

² Reichs-Kredit-Gesellschaft. "Germany's Economic Situation at the Turn of 1937/38".

available by increased tax revenue and decreased expenditure on unemployment relief:

German Budgetary Improvement since 1932.

Financial years	RM. (000,000's).		
	Revenue from taxation and Customs	Unemployment relief	Excess of revenue over unemployment relief
1932/33	10,200	2,800	7,400
1933/34	10,600	2,300	8,300
1934/35	11,800	1,600	10,200
1935/36	13,300	1,300	12,000
1936/37	15,500	900	14,600
1937/38 (estimate) . .	18,000	400	17,600

Figures of the issues of special bills for the finance of re-armament and special public works are not published.¹ It is impossible to say how many bills have been absorbed by other investors, but the following figures² show the total holding of bills by the German banks; and since the recovery has been so largely based on Government expenditure, it is probable that the greater part of this increase in bill holdings is due to Government finance.

Commercial and Treasury Bill Holdings of German Banks.

End of October:	RM. (000,000's).				
	1928	1932	1935	1938	1937
	6,497	6,403	10,868	12,850	14,626

At the same time, the following sums were borrowed by means of 4½% long-term consolidating loans:

	RM. (000,000's).
During 1935.	1,636
„ 1936.	2,623
„ 1937.	2,852 ³

Such figures as are available suggest, therefore, that increased tax revenue, savings on unemployment relief, short-term and

¹ A non-German private estimate, that of the *Neue Zürcher Zeitung* of October 29th, 1937, taken together with that given by PRIESTER in *Das Deutsche Wirtschaftswunder*, would make it appear that the total circulation of special bills increased from RM. 8,600 million in September 1936 to 12,600 million in September 1937.

² Reichs-Kredit-Gesellschaft, *op. cit.*

³ Jan.-Oct. 1937. An additional consolidation loan of RM. 1,000 million was announced in December 1937, and was raised to RM. 1,200 million in January 1938.

long-term borrowing, have all played an important part in the finance of Germany's public works and rearmament. The effort which this State activity involves is illustrated by the fact that, in 1937, RM. 19,600 million were paid in public revenue (inclusive of unemployment insurance contributions) out of an estimated national income of RM. 68,500 million.¹ In other words, 28.6% of the national income must be paid in revenue to the State, excluding sums lent to the Government on short- or long-term and excluding any other contributions to public and party organisations.

JAPAN

Japan also had not experienced any marked recession in economic activity by the end of 1937 as a consequence of the American recession. As will be seen later, certain difficulties have been experienced in the sale of Japanese products in foreign markets; but owing to heavy Government expenditures on the armed forces in prosecution of the war against China, the internal money demand for goods and services in Japan was maintained, and no recession in business activity was apparent. The very rapid and extensive rise in industrial production and employment since 1932, which is shown in the graph on page 12, reflects, not only the recovery of business, but also the rapid industrialisation of the country. This expansion has been aided by exceptionally low rates of interest; and, as the index of interest rates in the graph on page 12 shows, this low level of interest rates was maintained throughout 1937 in spite of the extra demands for funds on the part of the Government to finance the war against China.² The Japanese index of industrial share prices fell rapidly at the beginning of the second half of 1937; but this fall, which was probably caused largely by the stock-exchange slump in the United States, was only temporary and, under the influence of profits, stimulated by high Government expenditure for war purposes, stock-exchange prices quickly recovered the greater part of their losses.

As in most other countries, there was a rapid rise in wholesale prices towards the end of 1936 and during the first months of 1937; but, as can be seen from the graphs on pages 10 to 12, the rise in wholesale prices was considerably greater in Japan than in the United Kingdom or the United States of America, and there has been very little fall since the spring of 1937. This

¹ Reichs-Kredit-Gesellschaft, *op. cit.*

² The monetary measures taken for this purpose will be discussed in Chapter V.

rapid rise in prices led to widespread protests and to strikes, and in consequence a Commodity Price Board was set up in May 1937 to control prices. These rising prices were accompanied, in the months before the outbreak of the war, by a remarkable rise in imports, as the following figures show:

Japanese Imports and Exports.

Yen (000,000's).

Period	Imports			Exports			Balance		
	1936	1937	1938	1936	1937	1938	1936	1937	1938
1st quarter	760.4	992.2	619.7	572.0	686.1	565.4	-188.4	-306.1	-54.3
2nd quarter	702.9	1122.0	...	619.4	809.6	...	-83.5	-312.4	...
3rd quarter	569.9	912.8	...	682.0	812.2	...	+112.1	-100.6	...
4th quarter	668.6	705.6	...	757.9	816.4	...	+89.3	+110.8	...

The very high level of imports in the beginning of 1937 intensified the foreign exchange difficulties of Japan and led to the reinforcement of exchange control and to shipments of gold to the United States of America. In the last months of 1937 and the early months of 1938, Japanese exports ceased to rise and began to fall, as a result of unofficial boycotts, of the fall in buying power in the American and other markets, and of the growing scarcity of raw materials for the manufacture of Japanese exports in view of the demands for war purposes.

But, in spite of certain difficulties in export markets, economic activity in Japan has been fully maintained by State expenditure for war purposes. The importance of this expenditure can be appreciated from the fact that total Government expenditure, which was 1,476 million yen in the financial year 1931/32, was estimated to be 5,475 millions for the year 1937/38 and 7,718 millions for the year 1938/39 after the inclusion of special supplementary appropriations for the finance of the war. With these figures may be compared an estimated national income of 13,109 million yen in 1936.¹ Tax receipts are expected to cover less than half of the expenditure during the financial year 1937/38, and the Government is authorised to issue bonds to the value of 3,394 million yen to meet the deficit.² In fact, the Japanese Government bonded

¹ Mitsubishi Economic Research Bureau, *Monthly Circular*, April 1937.
² 1,300 millions of such bonds had been issued by December 1937.

debt increased from 10,395 to 11,893 million yen between December 1936 and December 1937.

The war against China has raised two major economic problems for Japan: the problem of maintaining necessary imports in sufficient volume and the problem of raising the sums necessary to finance the war expenditure. To meet the former problem, control both of foreign exchange and of foreign trade has been instituted. Since the Capital Flight Prevention Law of 1932, the exchanges had been regulated to prevent the movement of capital funds abroad; but, from January 1937, all foreign exchange purchases, even for the finance of commodity imports, were subjected to Government licence, and power was taken to control the use of foreign assets held abroad by Japanese nationals. In September 1937, the Foreign Trade Control Law prohibited certain imports and restricted others, so that a saving in foreign exchange of 196 million yen — or 7% of the total volume of imports in 1936 — was expected.¹

By the Capital Control Law enacted in September 1937, enterprises were divided into three classes, in the first of which investment was encouraged, in the second of which investment was restricted, and in the third of which investment was prohibited. This measure was designed to guide investment into branches of industry which were necessary for the prosecution of the war and to prevent unnecessary competition with Government borrowing on the capital market. Further, this law authorised the Industrial Bank of Japan to issue up to 500 million yen of Government guaranteed debentures in order to assist the financing of war industries, and authorised the Hypothec Bank of Japan to issue 200 million yen of saving certificates in order to collect savings from the small investor. Earlier, in August 1937, the Bank of Japan had been authorised to purchase Government securities in the market in order to help the Government in financing the war; and in this same month the gold reserves of the Central Banks had been revalued at a higher price in yen. Of the resulting profit of approximately 800 million yen, 418 millions were used for the formation of an Exchange Equalisation Fund and over 200 millions were set aside for investment in Government bonds.

THE SITUATION IN OTHER COUNTRIES

In a majority of countries, 1937 was a year of prosperity marked by a cessation of advance or, in some cases, by actual recession in the closing months. Both the Netherlands and

¹ *Oriental Economist*, October 1937.

Switzerland, for example, experienced a great revival of trade and industry in 1937, owing to the devaluation of their currencies in October 1936 and to the recovery in world markets. For both these reasons, Switzerland enjoyed a great improvement in tourist traffic. But in both countries commodity prices and industrial share prices fell in the second half of 1937; and in the Netherlands there was a considerable decline in production and rise in unemployment. Belgium also enjoyed good trade during 1937; but employment ceased to increase after the middle of the year, and industrial production showed a slight decline in the closing months.

The experience of the Scandinavian countries was similar. In Sweden, there was a very high level of activity during 1937, and at the beginning of the year there was some discussion concerning the advisability of taking measures, such as the appreciation of the krona in terms of sterling, to reduce the speed of the recovery. By the middle of the year, industrial production was more than 50% greater than in 1929. Since then, the expansion has ceased; but, while industrial production has remained more or less stable at this exceptionally high level, commodity prices and industrial share prices have fallen. Meanwhile, the Swedish Government has expressed its intention to take powers to combat any future slump by means of planned public works expenditure on the basis of a report, published at the end of 1937, which analysed the expenditure plans of central and local authorities for future periods of five and ten years. In Norway also, 1937 was a year of exceptional prosperity, based largely on the shipping boom and the great rise in shipping freights at the end of 1936 and beginning of 1937. Freight-rates fell again after the first half of 1937;¹ and economic activity in Norway declined somewhat in the last months of 1937, although it remained at a high level. Denmark also experienced some setback in the autumn of 1937; for while her agricultural producers enjoyed an increasing demand for their products, there was some fall in commodity prices, in share values and in industrial production in the autumn.

In the previous sections of this chapter, the experiences of the most important industrialised countries have been examined. It is of equal importance to bear in mind the repercussions of these experiences on the economies of those countries which are the main sources of supply of primary commodities. The prosperity of these countries is directly dependent upon the world markets for their exports and upon the buying power

¹ Cf. Chapter IV.

of the industrialised countries; thus their imports of industrial products normally follow, with some delay, their own sales of primary products. The following table gives quarterly

Total Exports of Certain Countries producing Primary Products.

Old U.S.A. gold \$ (000,000's).

Countries	1936				1937				1938	
	I	II	III	IV	I	II	III	IV	I	II
Australia Canada New Zealand	250.9	224.0	238.0	325.6	296.9	291.8	274.3	203.7	256.3	...
Netherlands Indies	57.3	56.3	57.3	62.2	73.3	84.6	85.5	79.4	66.7	...
Argentina Brazil Chile	134.8	113.8	147.2	169.8	238.6	196.5	172.1	151.1	134.3	...
Hungary Roumania Yugoslavia	46.2	46.2	68.9	80.8	71.1	81.3	82.8	88.8	60.7	...
Total	489.2	440.3	511.4	638.4	679.9	654.2	614.7	613.0	518.0	...

figures for the value of exports of certain groups of important countries of this character. The trend in the figures is unmistakable. There was a very rapid rise in export values at the end of 1936 and beginning of 1937 due both to the rise in prices of primary products and to the increased quantities purchased by the industrialised countries. The middle of 1937, however, saw a serious decline; and the total value of these countries' exports in the last quarter of 1937 was below the corresponding figure in 1936.

While this general trend is quite clear, there have been considerable divergences in the experiences of the different groups of countries. For example, the exports of the Balkan agricultural countries continued to grow throughout 1937. The Netherlands Indies gained greatly in competitive power in export markets through the devaluation of the gulden in the autumn of 1936; and, although their exports showed a marked fall between the third and fourth quarters of 1937, they remained higher in the fourth quarter of that year than they had been in the corresponding period of 1936. In Australia and New Zealand, 1937 was a year of real prosperity, and there were few, if any, signs of depression by the end of the year; but the strong upward movement of the last two years had ceased.

South-American exports were extremely high in value during the first half of 1937, but fell markedly in the second half of the year. Argentine's exports for the first half of 1937 were higher in value than in any corresponding period since 1920 and were greater in volume than ever before in the country's history. This result was due to the combination of the good harvests of 1936/37 with the high prices of primary products at the beginning of 1937. Harvest prospects for 1937/38 were, however, bad and the prices of primary products had fallen since the second quarter of 1937. In consequence, there was a serious decline in export values after the middle of 1937. In November 1937, Brazil decided that, in view of the continuing diminution of her share in the world market for coffee, she would no longer attempt alone to maintain its price; and the tax on coffee exports was reduced from 45 to 12 milreis a bag. The consequent fall in prices, together with the reduced purchasing power in the American market, has been unfavourable to the value of Brazilian exports. In Chile, conditions remained favourable up to the middle of the year, when mining activity reached a high level; but there was a marked fall in activity in the second half of the year.

As will be seen in Chapter VIII, there was a tendency for exchange restrictions to be relaxed in the South-American countries in the first part of 1937 and for these restrictions to be increased again subsequently; and this movement is symptomatic of the expansion of exports of primary products in the first half of 1937 and of the subsequent contraction of such export opportunities due to the recession in the industrialised countries. Another movement which is symptomatic of this trend is the reductions at the end of 1937 and the beginning of 1938 in the export quotas permitted by the international regulation schemes for such commodities as rubber, tin and copper. These greater restrictions, which have been made necessary by the fall in the demand of the industrial countries, will also be discussed in Chapter VIII.

Chapter II

EMPLOYMENT AND WAGES

EMPLOYMENT AND UNEMPLOYMENT

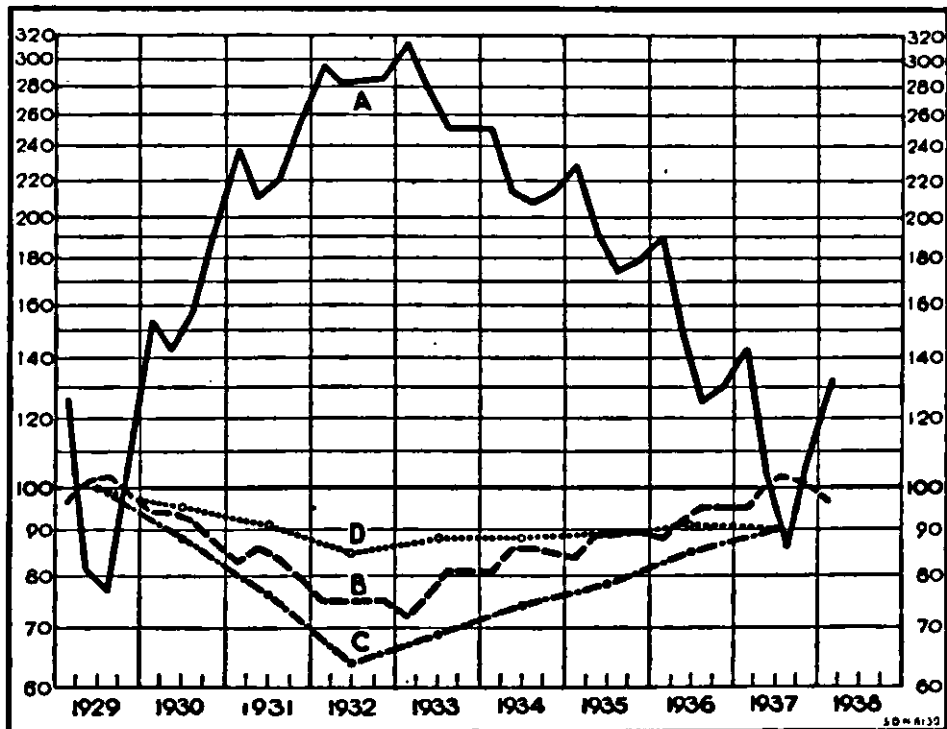
In the preceding chapter, an outline has been given of the rapid recovery which took place in most countries up to the autumn of 1937, and of the subsequent slowing-up of this process. Fluctuations in unemployment also clearly show this change in trend. From the graph on this page, it can

World Employment and Unemployment.

(1929 = 100.)

- | | |
|--|---------------------------|
| A Degree of unemployment. ^a | C Aggregate hours worked. |
| B Workers in employment. ^b | D Hours per worker. |

(Logarithmic scale.)



^a Excluding Italy in the last quarter of 1935 and in 1936 and 1937.

^b Excluding France in 1929.

be seen that world unemployment,¹ according to the figures calculated by the International Labour Office, rose rapidly between 1929 and the beginning of 1933, and then fell back to the 1929 level by the middle of 1937; but, at the end of 1937 and the beginning of 1938, there was a sharp rise in unemployment which cannot be fully explained by the fact that unemployment normally rises somewhat at this season of the year.

The figures of employment tell the same story. There was a fall in employment between 1929 and 1932, a rise between 1932 and 1937, and some small reduction towards the end of 1937. But, in order to discuss these fluctuations in employment in greater detail, it is necessary to distinguish between different ways of measuring the volume of employment. First, it is possible simply to measure the total number of workers employed; and fluctuations in this figure are shown by the curve of "Workers in Employment" in the graph on page 43. Secondly, just as the degree of unemployment may be measured by the proportion of employable workers who are unemployed, so the degree of employment may be measured by the proportion of employable workers who are employed rather than by the absolute number in employment. Fluctuations in this figure are not shown in the graph on page 43; but, as the number of employable workers has grown between 1929 and 1937, the curve showing the proportion of workers in employment would in 1937 lie below the curve showing the absolute number employed.² Thirdly, if it is desired to measure the amount of work done, account must be taken, not only of changes in the number of workers employed, but also of changes in the number of hours worked per week by each worker. For this purpose, it is necessary to consider the total number of hours worked by all employed workers, annual figures of which are given in the graph on page 43. If hours of work are considerably reduced — as has in fact happened since 1929 — the curve showing the total number of hours worked will fall below the curve showing the number of workers employed.

The graph on page 43 shows that, for the world as a whole, the number of workers employed fell from 1929 to 1932, rose until the middle of 1937, and then suffered a more than seasonal decline towards the end of the year. The number of hours worked by each worker also fell between 1929 and 1932, because

¹ The curve of world unemployment shows fluctuations in the proportion of employable workers who are unemployed. Between 1929 and 1937 there was a growth in the numbers of the population of working-age; and therefore there still remained a greater absolute number of persons unemployed in 1937 than in 1929, although the proportion of workers unemployed had fallen to the 1929 level.

² The International Labour Office's index of the number of workers in employment is the same for the year 1937 as for the year 1929, whereas the index of the proportion of available workers in employment still remained 3% below the 1929 level.

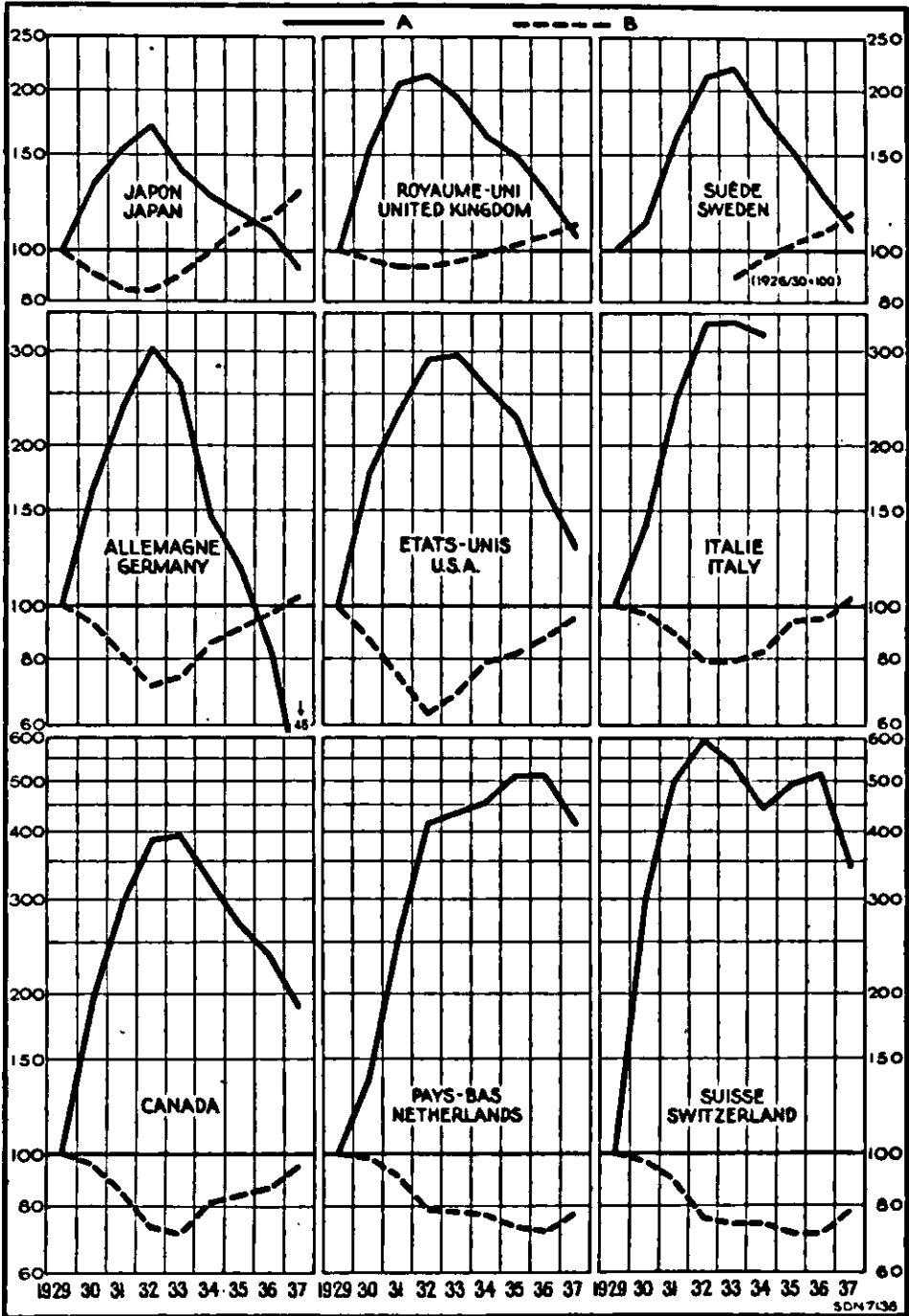
Employment and Unemployment in Nine Countries.

(1929 = 100.)

A Degree of unemployment.

B Number employed.

(Logarithmic scale.)



of the prevalence of short-time during the depression. Since 1932, there has been some rise in the number of hours worked by each worker; but this rise has been comparatively small because many countries have recently introduced shorter hours of work as a permanent measure of social policy, so that the short-time due to the depression has given place to an organised increase in workers' leisure. In consequence, the total number of hours worked fell between 1929 and 1932 more rapidly than the number of workers employed, and still remains at a lower level. In 1937, the International Labour Office's world index of the number of workers in employment had exactly regained the 1929 level, while the index of total number of hours worked remained 10% below the 1929 level.

The experience of different countries varied considerably during the depression and subsequent recovery. This can be seen from the graph on page 45, which shows fluctuations in the degree of unemployment and in the number of workers employed for nine different countries. These figures may be compared with the world indices in the preceding graph. In Japan, the United Kingdom, Sweden, Germany, and Italy, the number employed in 1937 had risen above the 1929 level. In Germany, the proportion of workers unemployed in 1937 had fallen far below the 1929 level, while the number employed was only 4% above the 1929 level. As has already been remarked in the last chapter, this is to be explained in part by the withdrawal of a considerable number of workers into the armed forces and into the labour corps, whose members are counted neither among the employed nor among the unemployed. In Japan, the very rapid rise in the number employed is a reflection of the rapid industrialisation of the country, which is drawing an increasing proportion of the population into industrial employment. In the United Kingdom, expansion had not fully caught up the growth of the working population, so that the degree of unemployment in 1937 remained somewhat above the 1929 level, although the number employed was 12.4% higher than in 1929. In Italy, the increase in the number employed has been largely due to the introduction of the forty-hour week and the consequent reduction of the hours worked per worker; for while the number employed in 1937 was 4.5% greater than in 1929, the total number of hours worked was 8.2% lower.

On the other hand, ten of the twenty-two countries for which statistics are available had an average level of employment in 1937 which was lower than in 1929:¹

¹ Cf. *Report of the Director of the International Labour Office, 1938*, page 25.

*Number employed in 1937 as a Percentage
of Number employed in 1929.*

Austria	67	Belgium	88
Luxemburg	75	Poland	88
Netherlands	78	Czechoslovakia	90
Switzerland	78	United States	95
France.	79*	Canada	96

* Number employed as a percentage of 1930.

Prominent in this list are the countries of the old gold bloc, which adopted deflationary policies until 1935 and 1936 in order to preserve the gold value of their currencies. In Belgium there was practically no fall in unemployment or increase in employment until after the devaluation of her currency in 1935. In Switzerland and the Netherlands, as can be seen from the graph on page 45, there was a practically continuous fall in employment until 1936, when these two countries depreciated their currencies. Although unemployment remains high in both these countries, a marked improvement is to be noticed between 1936 and 1937. Since the abandonment of the old gold parity of the franc in 1936, France has experienced peculiar difficulties, to which reference has been made in the preceding chapter; and, as can be seen from the graph on page 53, the total number of hours worked in France continued to fall between 1936 and 1937, although there was some increase in the number of workers in employment.

Percentage of Workers unemployed.

	1929	1932	1937
Australia	11.1	29.0	9.3
Austria	12.3	26.1	20.4
Belgium	4.3	39.7	21.3
Canada	5.7	22.0	10.8
Czechoslovakia	2.2	13.5	8.8
Denmark	15.5	31.7	21.9
Germany. . . . .	.	30.1	4.5
Japan . . . . .	.	6.8	3.7
Netherlands	7.1	29.5	29.2
Norway	15.4	30.8	20.0
Poland	4.9	11.8	14.6
Sweden	10.7	22.8	11.6
Switzerland	3.5	21.3	12.5
United Kingdom	10.4	22.1	10.9
United States	8.2	23.8	10.5

As the preceding figures¹ show, the percentage of workers unemployed in 1937 remained high, and in many cases was still considerably above the 1929 level.

Yet, in spite of these high levels of unemployment, there have been many complaints of shortages of skilled labour. This can be explained by a number of different factors. In many countries an insufficient number of apprentices were trained during the depression, so that a shortage of skilled labour became evident when the demand for labour increased to a high level in 1937. This shortage of key workers has, in some cases, prevented the employment of available unskilled workers. Shifts in demand and structural changes in industry which have occurred since 1929, are also responsible for the combination of a scarcity of certain types of labour with a high general level of unemployment. Some countries, for example, have lost important export markets either because of increased competition by other countries or because of protective policies adopted by their former customers, and in consequence they now experience a redundancy of certain types of labour trained for certain tasks and resident in certain districts, even though there is a shortage of labour in other occupations and other areas. The special areas and declining industries of the United Kingdom provide outstanding examples of this. The percentage of unemployed workers in the coal-mining districts of South Wales or the cotton-manufacturing districts of Lancashire remains high in spite of great activity in other districts.² The depression, by leading to an excessive development of protective measures in many countries and by delaying the transfer of workers to other industries, has greatly increased these problems of special unemployment. The rapid extension of rearmament expenditures has also created particular shortages of labour in two ways. It has drained men — often skilled men — into the armed forces, and at the same time has suddenly increased the demand for labour of a particular skill in the engineering and allied trades for the production of armaments.³

¹ The figures should not be used to make comparisons between the different countries, as there are important differences in the definitions of unemployment and in the methods of compiling the statistics.

² The percentage of workers unemployed in the special areas of England and Wales was 26.7 in March 1937, when the percentage for all districts was only 11.6. *Report of the Commissioner for the Special Areas in England and Wales*. November 1937.

³ "In addition, very large numbers of men have been withdrawn from industrial life into military service. No official figures are vouchsafed to the public; but the fact is beyond question. In China, Japan, Germany and Italy, hundreds of thousands of men have been incorporated in the armed forces. In Spain, the bulk of the male population is under arms. In other countries, such as France and the Netherlands, the period of military service has been extended. In Great Britain, the personnel of the Navy and Air Force has been rapidly expanded. The result is not only to diminish unemployment, particularly in countries where conscription operates, but also to reduce the number of skilled workers in industry. Modern armies, navies and air arms do not just require unlimited supplies of 'cannon-fodder', but also large numbers of artificers possessing a high degree of mechanical aptitude. This is undoubtedly a contributory cause, though not the main cause, of the shortage of skilled labour, which has been noted in many countries." — *Report of the Director of the International Labour Office, 1938*, page 27.

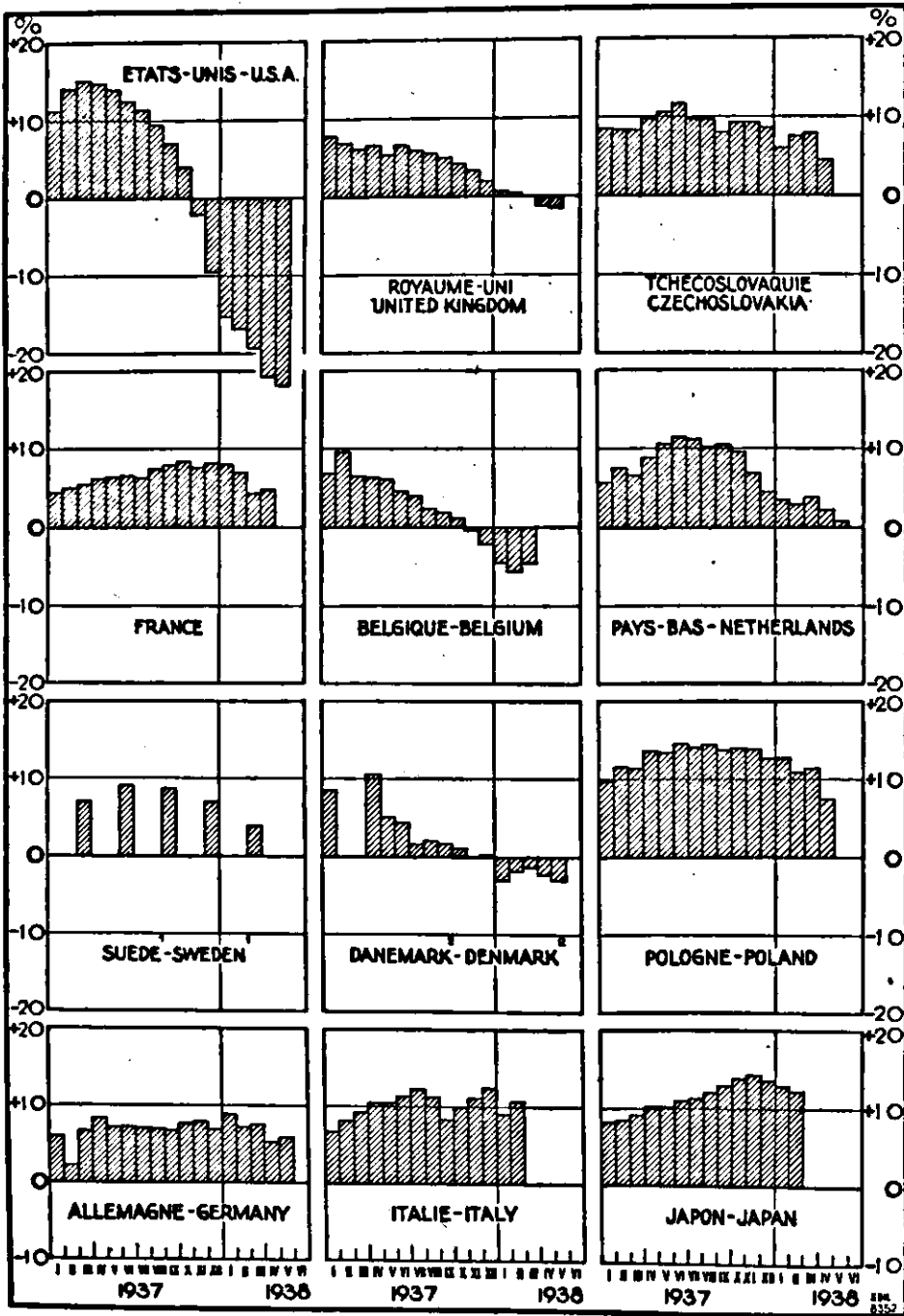
Thus, in France, the Committee on Production which reported in December 1937 emphasised the shortage of skilled labour in a number of occupations in spite of the low level of French production. In Germany, a high level of business activity, combined with the rapid development of the armed forces, has created a real shortage of labour; and a number of measures have been taken to deal with this situation. Labour is being imported from other countries to meet the shortage of agricultural workers. The transference of skilled independent workers into manufacture is being encouraged; the employment of female labour is being increased, and the grant of marriage loans since September 1937 is no longer conditional upon the withdrawal of the wife from her previous occupation; since June 1937, relief is no longer paid to short-time workers under 30 years of age who have no dependents; in April 1937, new regulations were issued to increase the number of apprentices taken on by industrial firms.¹ In addition, the length of the working-day has been increased in a number of occupations. The policy of stabilising money-wage rates in Germany has prevented the raising of wages by different employers in competition for the scarce labour supply; and this has necessitated measures to "ration" the supply of labour among different occupations. A decree of February 1937 prevented the transference of skilled labour in the metal trades from one employer to another except under special licence, and, in September 1937, the employment of skilled building workers in private and public concerns was subjected to the approval of the labour exchanges.¹ More comprehensive measures were taken by ordinances issued in March 1938, one of which required the permission of the labour offices before additional workers were taken on by any individual concern. In June 1938, all German citizens were made liable to "labour conscription" for work undertaken in the interests of the State; and the Government took powers to fix maximum, as well as minimum, rates of wages in order to curtail the competition of private industry for the available supplies of labour. In Belgium, several thousand foreign miners have been introduced to meet a scarcity of skilled miners at a time when there is still considerable unemployment in other occupations; and similar complaints of a shortage of skilled workers have come from Australia, Canada, Czechoslovakia, Greece, New Zealand, Poland, the United Kingdom and the United States.²

¹ Reichs-Kredit-Gesellschaft. *Germany's Economic Situation at the Turn of 1937/38.*

² Cf. *Report of the Director of the International Labour Office, 1938, page 27.*

*Percentage Changes in Employment as compared
with the Previous Year.*

(1929 = 100.)



¹ Sweden: quarterly figures.

² Denmark: II, III, 1937: figures incomparable owing to industrial dispute.

The recession in trade activity at the end of 1937 has already reduced the demand for labour in some countries, and in others it has reduced the rate at which the volume of employment is growing. The graph on page 50 shows for twelve countries the percentage change in the number of workers employed as compared with the number employed in the corresponding month of the previous year. For all these countries, some positive improvement is shown in the first three quarters of 1937 over the corresponding months of 1936. This improvement was particularly rapid in the United States, Czechoslovakia, the Netherlands, Italy, Japan and Poland. In the United States, by the end of 1937, not only had all the improvement achieved in the earlier months of the year been lost, but also employment was already 10% lower than it had been at the end of 1936. In Belgium and Denmark, employment at the turn of the years 1937-1938 was also lower than a year previously. In the United Kingdom, employment at the beginning of 1938 was on the same level as at the beginning of 1937, and the improvement achieved during the intervening months had been lost. In Czechoslovakia, the Netherlands and Sweden, some diminution in the rate of expansion was noticeable. In Germany, Italy, Japan, and France,¹ there were still no signs of a diminution in the rate of expansion of the demand for labour.

WAGES

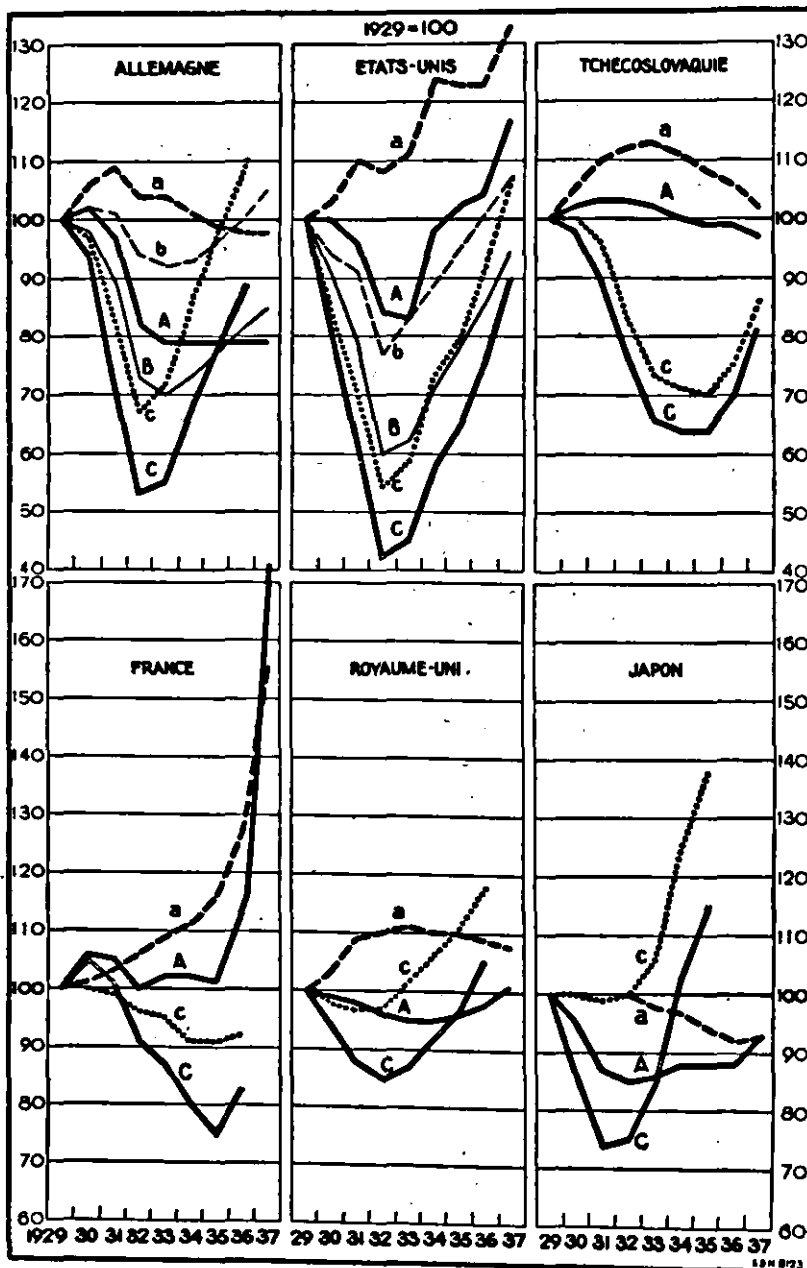
Discussion of the relationships between wages and the number of workers employed is often obscured by the fact that the word "wages" can be used with a great variety of different meanings. Thus "wages" may mean the rate of pay fixed for an hour's or a full week's work.² But, if account is taken of the number of hours actually worked in the week as well as of the wage-rate, "wages" will mean weekly earnings. Finally, if account is taken, not only of the wage-rate and of the number of hours worked by each worker, but also of the number of workers to whom employment is offered, "wages" will measure the total wage income of all workers. Moreover, wages may be measured either

¹ In France, the introduction of the forty-hour week at the end of 1936 and the beginning of 1937 has affected the figures, as a greater number of workers are required to perform the same total amount of work.

² Even in this case a distinction must be drawn in certain cases between the minimum hourly wage-rate guaranteed to the worker and the hourly earnings of the worker. Hourly earnings may exceed the minimum hourly wage-rate, if the worker is paid a piece-rate wage which depends upon his output.

Wages.
(1929 = 100.)

- | | |
|---|--|
| A Hourly money wages. ^a | a Hourly real wages. ^b |
| B Weekly money earnings. | b Weekly real earnings. |
| C Total money wages. | c Total real wages. ^c |



^a Japan: Daily earnings. — United Kingdom: Weekly rates. Figures for hourly wages and weekly earnings are not available.

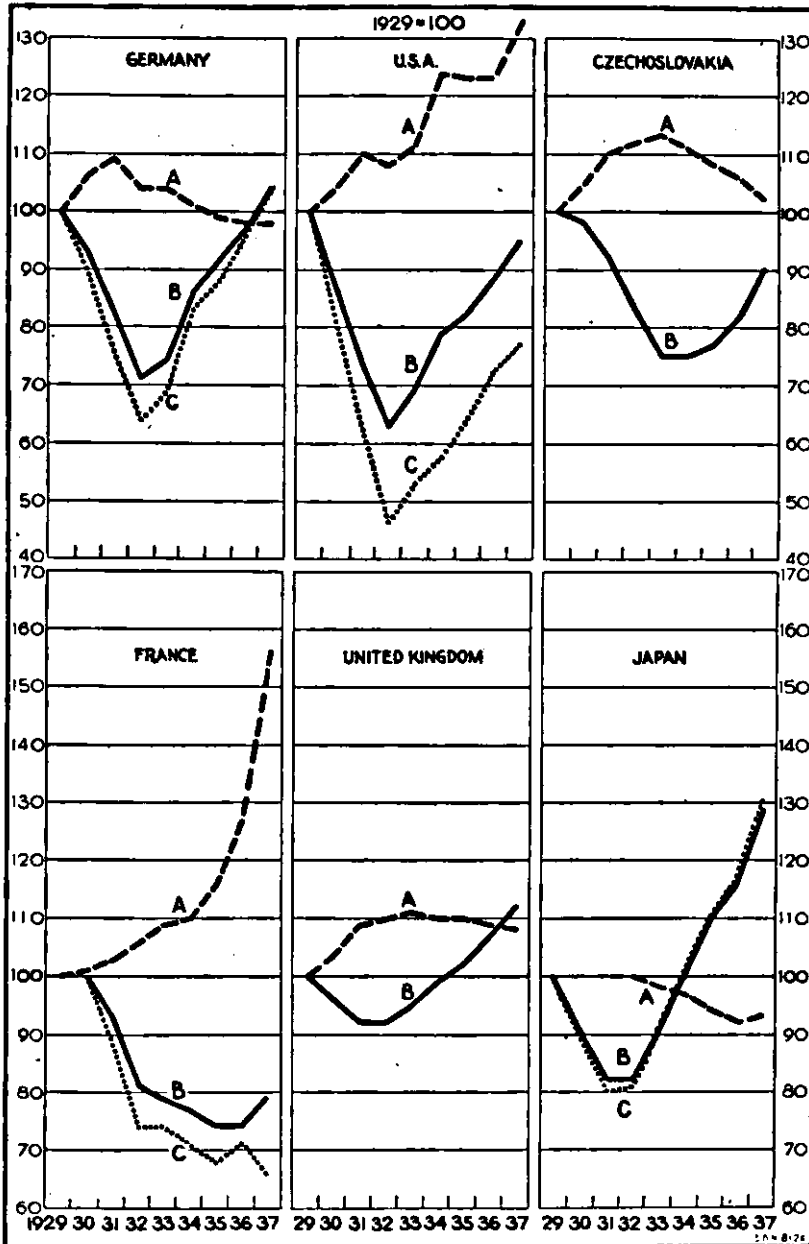
^b Japan: Daily earnings; base 1932 = 100. — United Kingdom: Weekly rates. Figures for hourly wages and weekly earnings are not available.

^c France: Base 1930 = 100.

Wages and Employment.

(1929 = 100.)

A Hourly real wages.^a B Number employed.^b C Aggregate hours worked.^c



^a Japan: Daily earnings; base 1932 = 100. — United Kingdom: Weekly rates. Figures for hourly wages and weekly earnings are not available.

^b France: Number employed in the same month of the year. Base 1930 = 100.

^c Germany, Japan: Series calculated by multiplying the average hours of work per worker per day by the number of workers employed. — France: Base 1930 = 100.

in terms of money or in terms of real purchasing power, which depends upon variations in the general level of prices. Variations in some of these different quantities — hourly wages measured in money and in real terms, weekly earnings measured in money and in real terms, and total wage income measured in money and in real terms, — are shown for six different countries between 1929 and 1937 in the graph on page 52.

During the great depression after 1929, the demand for goods and services diminished, and in consequence the price of commodities fell rapidly. In most countries, as can be seen from the graph on page 52, hourly money wages were reduced as the demand for labour fell; but in every case there was a greater fall in prices, so that hourly real wages rose. Weekly real earnings, however, fell during the depression in Germany and the United States, as can be seen from the graph on page 52, and probably also in other countries, for which information is not available; for the reduction in the hours of work which could be obtained by each worker, as short-time became prevalent, more than offset the rise in the hourly real wage. As the number of workers fell, total wage income was reduced even more than weekly earnings; and total wage income measured in real terms fell substantially in all the countries shown on page 52, with the exception of the United Kingdom and Japan.

Since the recovery, the opposite movements may be observed. In most countries, increased demand for goods and services has caused commodity prices to rise more rapidly than hourly money wages, and the hourly real wage has fallen. But the reduction in short-time and the increase in the number of workers employed have more than counterbalanced this, and the total real income of wage-earners has increased. In the United States and France, however, the rise in money wages was so rapid between 1936 and 1937 that the hourly real wage continued to rise. This phenomenon was very marked in France, where the introduction of the forty-hour week, together with some increase in weekly money earnings, has caused a very rapid rise in hourly wages.

While workers are primarily interested in the real purchasing power of their total wage income,¹ employers are chiefly concerned with the margin between the price which can be obtained for the product of a man's work and the money cost

¹ The figures of total real-wage income take no account of the benefits obtained from social services or other amenities provided without charge to the worker, such as the provision of holidays with pay or the German "Strength through Joy movement". Some examples of the rapid development of such services are given in a later section of this chapter.

represented by the wage paid for that work. When real hourly wages are raised — *i.e.*, when the margin between commodity prices and the money-wage cost becomes less favourable — employers are likely to diminish the amount of employment which they offer to labour. While there were, no doubt, other influences affecting the demand for labour, the importance of this factor is well illustrated by the graph on page 53. In the case of all the countries represented for which information is available, the fall in commodity prices between 1929 and 1932 caused a rise in the hourly real wage, and this was accompanied by a diminution in employment. In France, the hourly real wage has increased continuously since 1929, and the volume of employment as measured by the total number of hours worked fell to its minimum in 1937.¹ In Germany,

Money Wages by Quarters.

(1929 = 100.)

H.R. = Hourly rates.

H.E. = Hourly earnings.

W.R. = Weekly rates.

D.E. = Daily earnings.

Countries	Unit and scope	1936				1937				1938
		March	June	Sept.	Dec.	March	June	Sept.	Dec.	March
Australia	H.R.	84	84	85	86	86	87	89	92	...
Belgium	H.E.	84	85	91	91	95	98	100	102	...
Czechoslovakia (Prague)	H.R.	99	99	99	97	96	96	97	99	99
Denmark	H.E.	105	104	105	107	103	105	105	108	...
France (Paris region)	H.R.	101	108	124	131	162	172	173	183	187
Germany	H.R.	79	79	79	79	79	79	79	79	...
Italy	H.E.	86	88	94	95	95	104	104	104	...
Japan	D.E.	94	91	91	96	97	97	92	98	...
Netherlands	H.E.	.	81	.	80	.	81	.	83	.
New Zealand	W.R.	87	88	99	100	101	101	102	103	...
Poland	H.E.	71	71	71	73	71	72	73	76	76
United Kingdom	W.R.	99	99	100	100	102	103	104	105	107
United States	H.E.	104	105	105	108	112	120	121	121	121

¹ The sharp divergence in 1937 between the number of persons employed and the total number of hours worked was due to the introduction of the forty-hour week.

Czechoslovakia, the United Kingdom and Japan, the rise in prices after 1933 caused a fall in hourly real wages, and this has been accompanied by a recovery in employment. In the United States, the rapid rise in hourly money wages between 1936 and 1937 more than offset any rise in commodity prices, and hourly real wages reached a high level 33% above the 1929 figure. A considerable increase in employment occurred between 1932 and 1937 in spite of this continued rise in hourly real wages, but the total number of hours worked still remained more than 20% below the 1929 level.

More recent changes in money-wage rates are shown in the table on the preceding page.

In Germany, money-wage rates have, as a matter of policy, been stabilised at a constant figure in spite of the increasing demand for labour. In Czechoslovakia, Denmark, Japan, and the Netherlands also there has been little, if any, rise in money-wage rates during 1936 and 1937. But, in all the other countries shown in the table, the rise in demand for labour has given rise to substantial increases in money-wage rates in the course of 1936 and 1937. In some countries, this rise in money-wage rates is due, not only to the increasing demand for labour, but also to a more or less definite social policy adopted for the raising of workers' standards of remuneration. In the United States, in which there was a rapid rise of wage-rates in the first half of 1937, a decision of the United States Supreme Court which established the constitutionality of State minimum-wage legislation for women has led to a rapid development of such legislation by many States. At the same time, workers' demands for higher wages have been encouraged by the President's expressed desire that wages should be at least maintained in order to prevent a decline of consumers' purchasing power. In May 1937, a Bill was placed before Congress for the fixation of a minimum hourly money wage and for maximum weekly hours of work. After being shelved for some time, this measure was finally passed in June 1938 in a modified form, which fixed a minimum-wage rate rising over a period of seven years from 25 to 40 cents an hour, and maximum hours of work, falling, over a period of three years, from 44 to 40 hours of work. In France, hourly money wages have been raised very considerably since the middle of 1936 by various measures: the forty-hour week was introduced by stages throughout the French economy towards the end of 1936 and during the first part of 1937, and a rise in hourly wages was effected in order to prevent a fall in weekly earnings; legislation has been passed to make collective agreements legally binding on all workers and employers in the districts and trades to which these agreements

relate, and this has led to the widespread fixing of minimum wage-rates; and finally, compulsory arbitration to determine what wage increases are necessary to offset rises in the cost of living has been organised by means of a series of measures, culminating in an Act of March 1938, which enables the wage clauses of collective agreements to be reconsidered if the official cost-of-living index has varied by 5% or more. In both the United States and France, wage increases have been encouraged as part of the policy of the Government to maintain and expand purchasing power. In Australia, on the other hand, wage increases have been effected partly in order to achieve the opposite result: namely, to raise wage costs at the expense of profits in order to prevent the development of too rapid a boom. In 1930, the Australian Commonwealth Court of Conciliation and Arbitration had ruled a 10% cut in the real basic wage, the money equivalent of which is automatically adjusted to variations in the cost of living. As recovery developed, this cut was restored, and a final rise in wage-rates was granted by the Court in 1937; and, in forming its judgment, the Court attached considerable weight to the argument that higher wage-rates would restrain the development of over-optimistic expectations of profit and would thus check an undesirable boom.¹

Minimum-wage regulation has been developed during 1937 and the early part of 1938 in a number of countries, including Australia, the United Kingdom, Canada, Chile, Cuba, Czechoslovakia, Denmark, Ecuador, Estonia, France, Greece, the Netherlands, New Zealand, Norway, Peru, Poland, the Union of South Africa, the United States and Yugoslavia. This has been effected by many different methods. In some cases, minimum-wage rates have been fixed directly by legislation; in others, minimum-wage rates have been determined by the compulsory extension of collective agreements; in yet other cases, minimum-wage rates have been established by compulsory arbitration where no agreement has been reached.²

HOURS OF WORK

As the following table shows, hours of work fell in all countries between 1929 and 1932, as the intensification of the depression led to the spread of short-time working. It has already been explained in a previous section that the world index of hours worked by each worker has risen only slowly since

¹ Cf. W. B. REDDAWAY: "Australian Wage Policy, 1929-1937", *International Labour Review*, March 1938.

² Cf. *International Labour Office Year-book 1937/38*.

Number of Hours worked per Worker.

<i>World Index</i>	<i>1929 = 100</i>	1929	1932	1936	1937
		<i>100</i>	<i>85</i>	<i>92</i>	<i>90</i>
Estonia	Hours per day	8.18	7.86	8.00	8.03
Germany		7.67	6.91	7.59	7.68
Hungary		8.97	8.53	8.77	...
Japan		9.27	9.10	9.28	9.32
Finland ^a	Hours per week	46.5	45.45	46.6	47.55
France		.	.	45.8	40.4
Italy ^b		45.5	42.25	39.25	40.75
Norway		.	.	45.5	44.9
Poland		44.7	40.7	42.7	43.3
Sweden		.	43.5	47.4	47.1
United States		48.3	34.8	39.8	39.2

^a Based on figures of hours per fortnight.

^b Based on figures of hours per month.

recovery started in 1932, because in a number of countries the increase in workers' leisure which began in the depression as unorganised short-time has been continued in an organised manner through the introduction of the forty-hour week and similar measures. In 1934, the forty-hour week was introduced into Italy; in the same year, the codes for different industries in the United States under the National Recovery Administration introduced the forty-hour week, and although these codes were subsequently held to be unconstitutional, the shorter working-week has remained in most collective agreements¹; in 1936, the forty-hour week was introduced into France, New Zealand and Spain.

In a number of countries, some extension of the hours of work has occurred recently as a result of the recovery in the demand for labour, and in particular as a result of the increased demand for armaments. In Japan and in Spain, normal hours of work have been lengthened in the last year to meet the needs of war; in Germany, hours of work have been extended, particularly in the industries closely connected with the production of arms, to meet the shortage of labour; and in Italy, while the working-week of forty hours remains as the normal rule, a forty-eight-hour week may now be applied in certain districts and in certain classes of undertakings when an insufficient

¹ The reintroduction of a legal maximum of forty hours per week is envisaged in the Act passed in June 1938, to which reference is made on page 56.

number of workers are available.¹ But, in spite of these tendencies, the movement towards a shorter working-week has continued in a number of other countries. In Australia, Belgium, Luxembourg, Mexico, the Netherlands and Poland, hours have been reduced for certain classes of labour, in many cases to a maximum of forty per week. In the Scandinavian countries and in Switzerland, the reduction of working-hours has been the subject of serious discussion.² The most striking recent example of reduction of hours of work has been the introduction of the forty-hour week in France towards the end of 1936 and during the first months of 1937, as the main item in an extensive programme of social reform. Many critics of this policy have held the introduction of the forty-hour week in part responsible for the recent economic difficulties in France, which have been analysed at some length in the preceding chapter. The Committee on Production, which reported in December 1937 on the obstacles standing in the way of a recovery of the French economy, suggested a number of ways in which the application of the forty-hour week might be modified in order to promote an increase in industrial production. It suggested that a certain number of hours lost in slack periods of the year should be added to the permissible hours of work at a later period of the year; that special modifications should be made in cases in which the shortage of skilled labour prevented the full operation of industrial plant; that working by shifts should be permitted so that a forty-hour week for workers should not mean a forty-hour week for plant; and that special modifications should be allowed for industries producing armaments and capital equipment the demand for which could not otherwise be met.³

Workers' leisure has also been increased recently by the rapid extension in many countries of the right of the worker to an annual holiday with pay, either by means of legislation or through the inclusion of this right in collective agreements. During 1936, this tendency was particularly rapid, and the right to a holiday with pay was extended by legislation to large classes of workers in Belgium, Bulgaria, France, Ireland and Norway. The same movement continued at a less rapid rate during 1937. In Germany, Belgium and France, for example, the right was extended to further classes of workers. In the United Kingdom there has recently been a rapid increase in the number of workers enjoying the right to a free holiday; and a

¹ Cf. *Report of the Director of the International Labour Office, 1938*, Chapter III.

² In May 1938, a Government decree laid down a procedure which allowed for "the making-up of time lost by collective suspension of work, and for the exceptions with regard to overtime which are necessary in cases of exceptional pressure of work".

Government committee reported in April 1938 in favour of paid holidays, but proposed that legislation should be postponed until 1940 in order to give industry time to introduce its own schemes. In a number of countries, proposals are now under discussion for further extensions of the principle, and many other measures have recently been taken to increase the length of the annual holiday or to reduce the waiting period which must be served in order to acquire the right to a holiday with pay.

EXTENSION OF SOCIAL INSURANCE ¹

While the level of wages and the amount of leisure are the most important elements affecting the workers' standard of living, rises in this standard are, in the modern world, becoming more and more affected by extensions of social services and of schemes of social insurance. There have been many extensions of such schemes in recent years. In the United States, every State now has an unemployment compensation scheme in force; in one State benefits started in 1937, in twenty-nine States benefits are due to start in 1938, and in twenty-one other States in 1939. Plans have been made during 1937 for the inception or extension of unemployment insurance in the Union of South Africa, Australia, Belgium and Canada. Other forms of social insurance have also made rapid progress. In the United States, as many as 36,000,000 workers were registered at the end of 1937 for future old-age pensions, and almost every State had adopted schemes giving immediate benefits to the aged. In Japan, in spite of the war against China, there have been many important developments in the last year: sickness insurance has been organised on behalf of persons of small means who are outside the present scheme; the Japanese Government has announced its intention of setting up a scheme of pensions insurance for all industrial workers; and a new Ministry of Welfare was created in January 1938. In Norway, non-contributory old-age pensions have been introduced; in Denmark the age for the receipt of non-contributory old-age pensions has been reduced to 60; in Finland, a scheme of contributory pensions has been started. Australia and New Zealand have both prepared comprehensive schemes of health and pensions insurance. In Yugoslavia, all persons employed in industry and commerce have been brought under compulsory insurance against invalidity, old age and death. In Germany and the

¹ In the preparation of this section, extensive use has been made of the *Report of the Director of the International Labour Office, 1938.*

United Kingdom, opportunities for voluntary insurance against old age have been extended to independent workers, who are outside the ordinary insurance schemes; and many other countries are considering similar measures.

A most remarkable extension of social services and of social insurance has occurred during the past year in Latin America. In Brazil, all industrial workers are now covered by a scheme of pension insurance; in Chile, vigorous preventive measures have been taken against tuberculosis and other social diseases through the periodical examination of the members of the social insurance funds and through the payment of full wages to those who have to leave their work for the cure of incipient diseases; in Peru, a comprehensive scheme for sickness, maternity, invalidity, old-age and survivors' insurance came into force early in 1937; in Cuba, a special Social Insurance Committee has been set up to propose schemes of insurance against unemployment and all physical risks. In addition to such extensions of social insurance, the question of nutrition has been energetically taken up in the Argentine, Chile, Ecuador and Peru; and the improvement of housing conditions has been promoted* in the Argentine, Bolivia, Brazil, Chile, Colombia, Cuba, Ecuador, Mexico, Peru, Uruguay and Venezuela.

In many cases, this progress has been directly inspired or assisted by the International Labour Office;¹ and such instances of progress as it has been possible to enumerate briefly in this section show that the extension of social insurance and of other policies designed to raise the standards of living of the workers has proceeded at a rapid pace in all parts of the world during the past year.

¹ A full account of the Office's activities is contained in the *Report of the Director of the International Labour Office, 1933*, and the *International Labour Office Year-book 1937/38*.

Chapter III

PRODUCTION AND STOCKS

In the post-war years, it appears that two major cycles of trade activity have occurred — the first from the collapse of the post-war boom in 1920 until 1929, and the second from the beginning of the great depression in 1929 until the recent recession in trade activity which started in the United States in the early summer of 1937. Before examining the most recent movements in production, it is of interest to discuss the trends of production over the longer periods of these two post-war cycles. The following table¹ shows the annual per-

Annual Percentage Changes in Production per Head.

Area	Period	Production of foodstuffs	Manufacture of consumption goods	Manufacture of capital goods
World (including U.S.S.R.)	1920-1929	2.0 ^a	3.8	3.5
	1929-1937	—0.4	0.5	1.9
World (excluding U.S.S.R.)	1920-1929	1.4 ^a	3.1	3.5
	1929-1937	—0.2	—0.4	—0.6
Europe (excluding U.S.S.R.)	1920-1929	4.3 ^a	4.2	4.5
	1929-1937	0.3	0.2	0.5
North America	1920-1929	—1.3 ^a	1.4	2.5
	1929-1937	—1.0	—1.3	—2.4

^a Excluding meat and milk.

¹ The figures are taken from *World Production and Prices, 1937/38*, published by the League of Nations, Chapter I, where more detailed figures are discussed.

centage changes in production per head of population which took place in different areas of the world during these two periods. Certain developments are clearly indicated by these figures. In the first place, the increases in production per head which took place in the years 1920 to 1929 were considerably greater than those which occurred between 1929 and 1937. In the case of Europe, owing to the ravages of the war, production was at a low level in the early 1920's, so that a large percentage increase was attained in the following years. In North America, the percentage increases in production per head during the 1920's were for this reason less than in Europe; but in the period 1929 to 1937, actual decreases are to be observed for North-American production per head, as a result of the failure of American business to recover fully from the post-1929 depression.

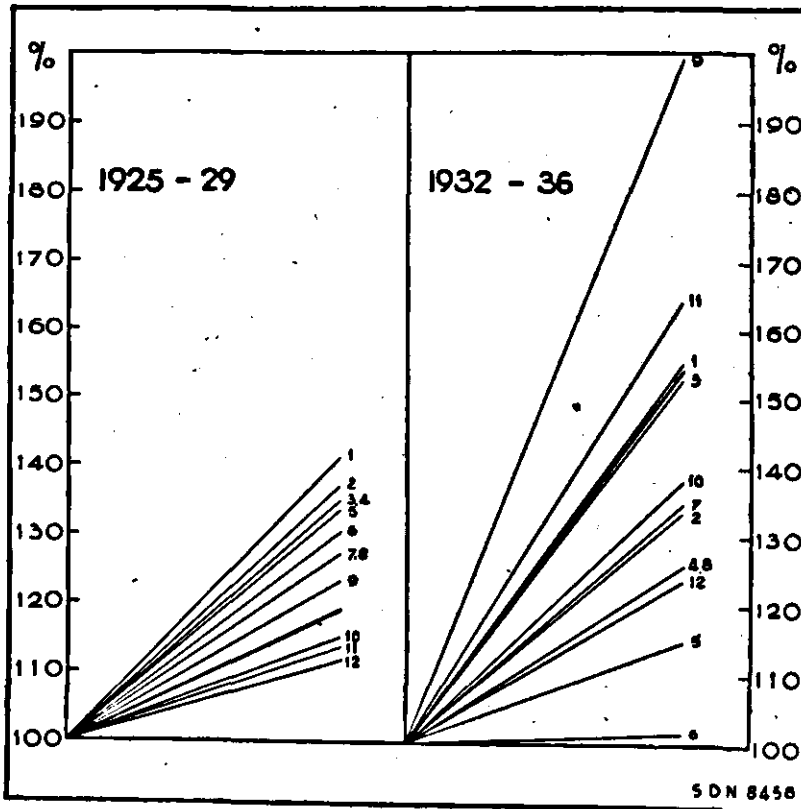
A second noticeable feature of the table is the diminution in the output of food per head in the world as a whole and in North America between 1929 and 1937. To some extent, this phenomenon must be attributed to the limitations of the index for food production, on which the figures are based. For the index does not include poultry, eggs, and fresh fruit and vegetables — foods which have grown considerably in relative importance in recent years. The substitution of these foodstuffs for others may mean that there has not, in fact, been any actual fall in the production of food per head of population in the world as a whole. During the war, European production of foodstuffs had been curtailed and North-American supplies had in consequence been over-developed. The decreases in food-production per head in North America between 1920 and 1929 and the increase in European production during the same period mark the post-war movement towards a restoration of the normal sources of supply. This movement was intensified by the development of agricultural protection in Europe; and, as a result of such protection and of the closely related attempts of the United States to restrict home production, the decrease in food-production continued in North America during the 1930's.

A third noticeable feature of the table is the importance of the recent rapid industrial development in the Union of Soviet Socialist Republics. Between 1929 and 1937, the exclusion of the Union of Soviet Socialist Republics from the world index changes an annual 2% increase in production per head of capital goods into a decrease of 0.6% per annum, and changes an annual increase of 0.5% in production of consumption goods to a decrease of 0.4% per annum. Even after making allowance for the fact that industrial production

started from a very low level, the rapid and continuous expansion of Russian production is one of the most remarkable and important of recent developments. On the other hand, the production of foodstuffs per head in the Union of Soviet Socialist Republics between 1929 and 1937 appears not only to have fallen, but also to have fallen more than in the rest of the world.

*Percentage Increase in Industrial Production
in Various Countries during the Periods 1925-1929
and 1932-1936.*

- World ———
- | | | |
|-------------|--------------------|--------------------|
| 1. Canada. | 5. Netherlands. | 9. Germany. |
| 2. Poland. | 6. France. | 10. Greece. |
| 3. Sweden. | 7. Austria. | 11. United States. |
| 4. Belgium. | 8. Czechoslovakia. | 12. Norway. |



It is clear that there have been considerable differences in the rate of development of production in different parts of the world over the period of the two post-war business cycles. The possibility of such differences of development during the

downswing or during the recovery movement in the trade cycle have become more marked in recent years as a result of the growth of protective trade policies, the institution of exchange control and the abandonment of a common international monetary standard. The greater independence of national economic systems which has resulted from these policies is well illustrated by the preceding graph,¹ which shows how much greater was the diversity in the rate of recovery of production in different countries between 1932 and 1936 than between 1925 and 1929.

The diversity of movements in industrial production in different countries during recent months is illustrated by the graph on page 71, and will be discussed in a later section.

PRIMARY PRODUCTION

Recent movements in the production and stocks of all primary commodities and of foodstuffs and raw materials separately are shown on the graph on page 66. The production of primary commodities rose during the period 1925 to 1929, and then fell during the subsequent slump until 1932. During the period of recovery, production increased again until in 1937 it was some 9½% above the 1929 level. These general movements of production were, however, composed of very different changes in the production of foodstuffs and of raw materials. As the graph clearly shows, the production of foodstuffs has remained much more stable than that of raw materials. This is to be explained on two grounds. In the first place, the supply of agricultural foodstuffs cannot easily or quickly be adjusted to changes in the demand, whereas the supply of mineral and other raw materials can often be more readily adjusted. This is particularly true of raw materials which are produced on a large scale or whose output is subjected to the control of restriction schemes.² In the second place, the demand for foodstuffs is much more stable than the demand for industrial raw materials, which is affected by the violent fluctuations that have occurred in the construction of capital instruments of production such as machinery, buildings, etc. As evidence for this greater stability of demand for

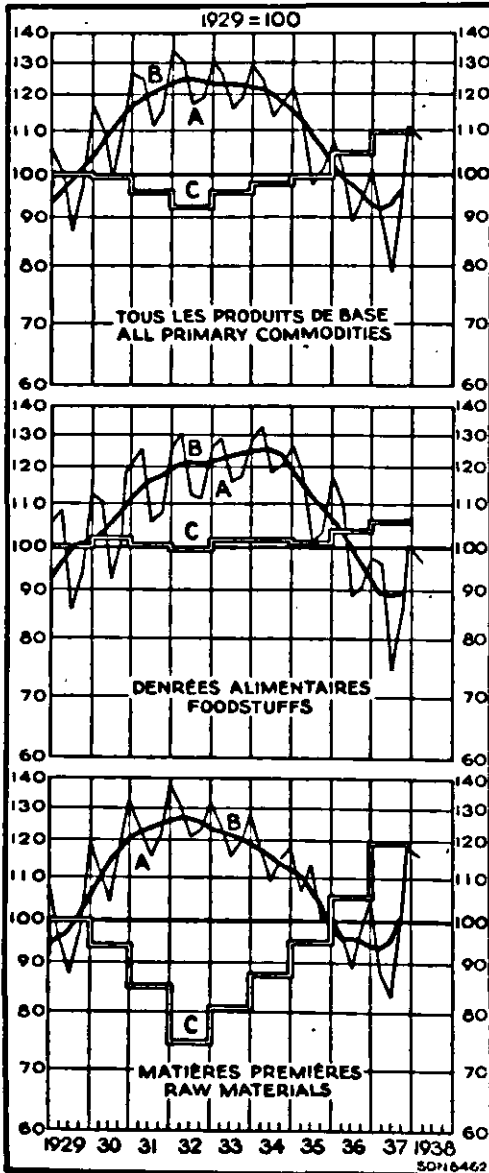
¹ The graph is reproduced from *Konjunkturläget Hösten, 1937. Meddelanden från Konjunkturinstitutet. Ser. A: 1, Stockholm, 1938.*

² A division of primary commodities into agricultural products and non-agricultural products gives very similar results as the division into foodstuffs and raw materials, which is shown in the graph.

*Production and Stocks
of Primary Commodities.*

(1929 = 100.)

- A Stocks (unadjusted index).
- B Stocks (adjusted index).
- C Production.



foodstuffs, the graph opposite shows that the production of foodstuffs did not fall at all between 1929 and 1932, whereas the production of raw materials in 1932 was as much as 25.4% below the 1929 level. At the same time, stocks of both foodstuffs and raw materials rose by between 25% and 30% during the depression. On the other hand, by 1937 the production of foodstuffs was only some 5½% above the 1929 level, whereas the production of raw materials was as much as 19% above the 1929 level, as a result of the recovery in industrial demand and of the demands for rearmament purposes.

During the course of 1937, the markets for primary products experienced a marked change; for the heavy and growing demand for raw materials gave place to a dramatic reduction, first as a result of the cessation of speculative demands at the end of the first quarter of 1937, and later as a result of the severe contraction of industrial activity in the United States.¹

¹ In Chapter VI, page 124, the dependence of American imports of raw materials upon the level of American industrial activity is discussed; and on page 79, evidence is given of the great importance of the American demand in the markets for certain raw materials.

The effect of these developments is clearly shown by the movements of stocks, illustrated in the graph on page 66. By the beginning of 1937, the visible stocks of all primary commodities, and also of foodstuffs and of raw materials separately, had fallen considerably below the 1929 level. But, during the last half of 1937, all these stocks rose sharply, and the upward movement was considerably more than is normal at that season of the year. By the end of 1937, the visible stocks of raw materials, which were naturally the most affected by these developments, had risen to a figure as high as that reached at the end of 1934 and were almost as high as they had been at the end of 1929. Visible stocks of raw materials do not include manufacturers' inventories of raw materials, of goods in process of manufacture, and of finished goods. Movements of such inventories in the United States during 1936 and 1937 have been discussed in Chapter I, page 22. It has recently been estimated that stocks in the hands of manufacturers, wholesalers and retailers in the United States increased in a smaller proportion than sales during 1936, but in a greater proportion than sales during 1937. The same authority interprets these figures as suggesting that, "while inventories were not out of line with sales at the end of 1936 and presumably were not, therefore, the initiating force in bringing the decline in the spring, their accumulation during 1937 was an important factor in deepening and prolonging the recession".¹

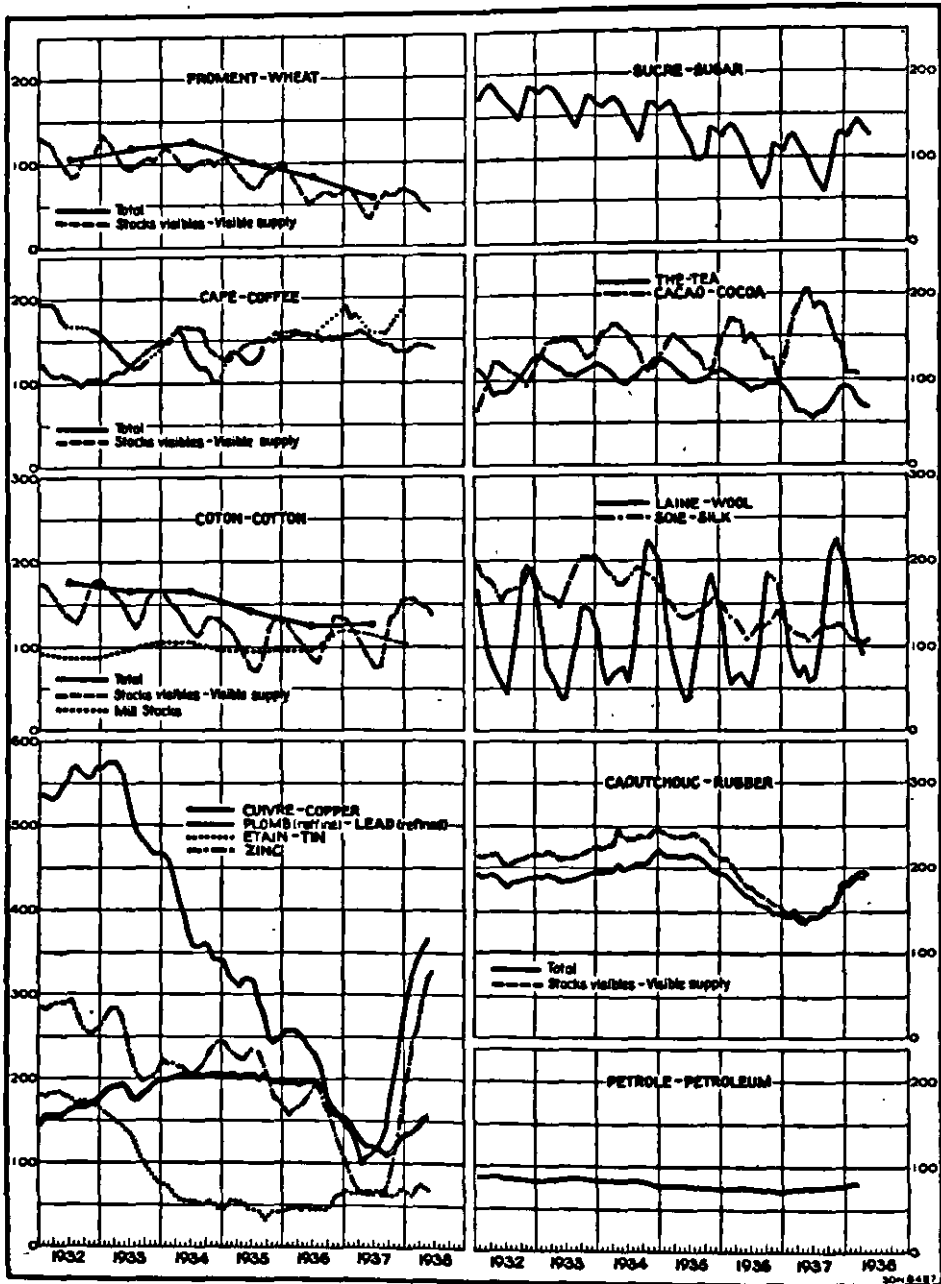
Recent movements in the stocks of individual commodities are shown on the graph on page 68, from which it can be seen that very substantial increases in stocks have occurred in the case of rubber and of various metals since the onset of the American depression in the middle of 1937. The increased stocks of cotton and, to a lesser extent, of wheat are due not so much to reduced demand as to large crops in the United States. The American cotton crop of 1937 is estimated to have reached the record figure of 18.7 million bales, as compared with the previous record of 18.0 million bales in 1926, and this record crop was attained in spite of the fact that the area sown had been reduced from 44.6 million to 33.9 million acres between 1926 and 1937. In the case of wheat, after a series of droughts and of poor crops in North America, there was a better crop in 1937; and there is the prospect of a still greater crop in 1938.²

¹ *Dun's Review*, May 1938, published by Dun & Bradstreet, Inc.

² In February 1938, an extensive Agricultural Adjustment Act was passed in the United States, which gave the Secretary of Agriculture wide powers to regulate the production and marketing of the main agricultural products by fixing production and marketing quotas to prevent over-production.

Stocks of Primary Commodities.

(1929 = 100).



The following table illustrates the changes in output of certain important primary products:

World Production of Certain Primary Products.

(1929 = 100.)

	1933	1936	1937
Wheat ^a	106	98	105
Coffee	109	109	105
Cotton	100	119	144
Raw wool	95	81	99
Rubber ^b	98	99	131
Coal	76	94	98
Petroleum	96	119	135
Copper (smelter production) ^c	55	91	121
Tin ^c	45	93	107

^a World crop of wheat, excluding the Union of Soviet Socialist Republics, China, Iran and Iraq.

^b World shipments.

^c Base: 1925/29 = 100.

The production of all these products, except coffee, increased between 1936 and 1937. As has already been explained, in the case of wheat and of cotton, the increases are primarily due to bigger crops in the United States. During 1937, owing to rearmament activity and to the high level of industrial activity, there was a large demand for the other raw materials shown in the table. This demand was met to a large extent by increased production, which in many cases was made possible by relaxation of the restriction schemes which controlled production or export of the commodity. With the fall in industrial demand towards the end of 1937, the control of these restriction schemes was again tightened and production was curtailed; but, as has been seen above, this restriction was not sufficiently prompt or severe to prevent an accumulation of stocks.¹

INDUSTRIAL PRODUCTION

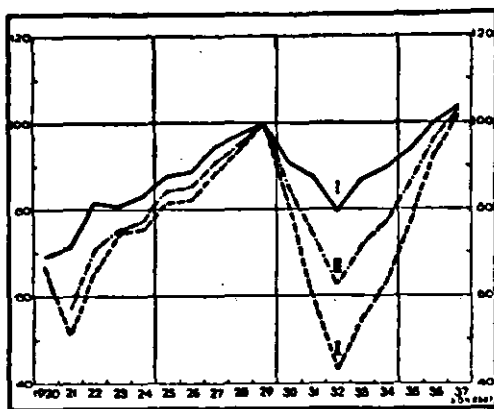
By 1937, the world index of manufacturing production (excluding the U.S.S.R.) had risen slightly above the 1929 level, after having fallen as much as 37.4% between 1929 and 1932. As is well known, during a depression, the demand for consumption goods falls off less than the demand for goods used for the purpose of constructing capital equipment, since, on the one hand, expenditure on consumption goods cannot be

¹ Cf. Chapter VIII for the recent history of the restriction schemes for different primary products.

World^a Manufacture of Capital Goods and Consumption Goods.^b

(1929 = 100).

- I Consumption goods.
- II Capital goods.
- III All goods.



^a Excluding the U.S.S.R.
^b Figures from 1921-1924 based on a series calculated by the *German Institut für Konjunkturforschung*. Later figures calculated by the *Economic Intelligence Service* of the League of Nations.

so easily postponed as the accumulation of savings, and, on the other hand, little prospect for the profitable employment of newly constructed capital equipment exists during a period of declining trade. For these reasons, the manufacture of capital goods falls more rapidly during a depression, and rises more rapidly during recovery, than the manufacture of consumption goods. These movements are well illustrated in the accompanying graph, which shows the relative rapid fall in the production of capital goods between 1929 and 1932, and the later rapid rise in such production, until in 1937 the former relationship between the manufacture of

consumption goods and of capital goods had been attained with production slightly in excess of the 1929 level.

In the course of 1937, the upward trend of manufacturing production gave place to a recession in many countries. In the United States of America, the manufacture of consumption goods had been falling gradually since the beginning of 1937; but the production of capital goods was well maintained until the autumn, when it suffered a very sharp and extensive fall.¹ The way in which the failure of consumption demand to rise may subsequently have caused the sharp decline in investment activity in the United States has already been discussed at length in Chapter I. On the other hand, in Europe as a whole, a decline in the production of capital goods started in the early autumn of 1937, some three months before the production of consumers' goods reached its peak.²

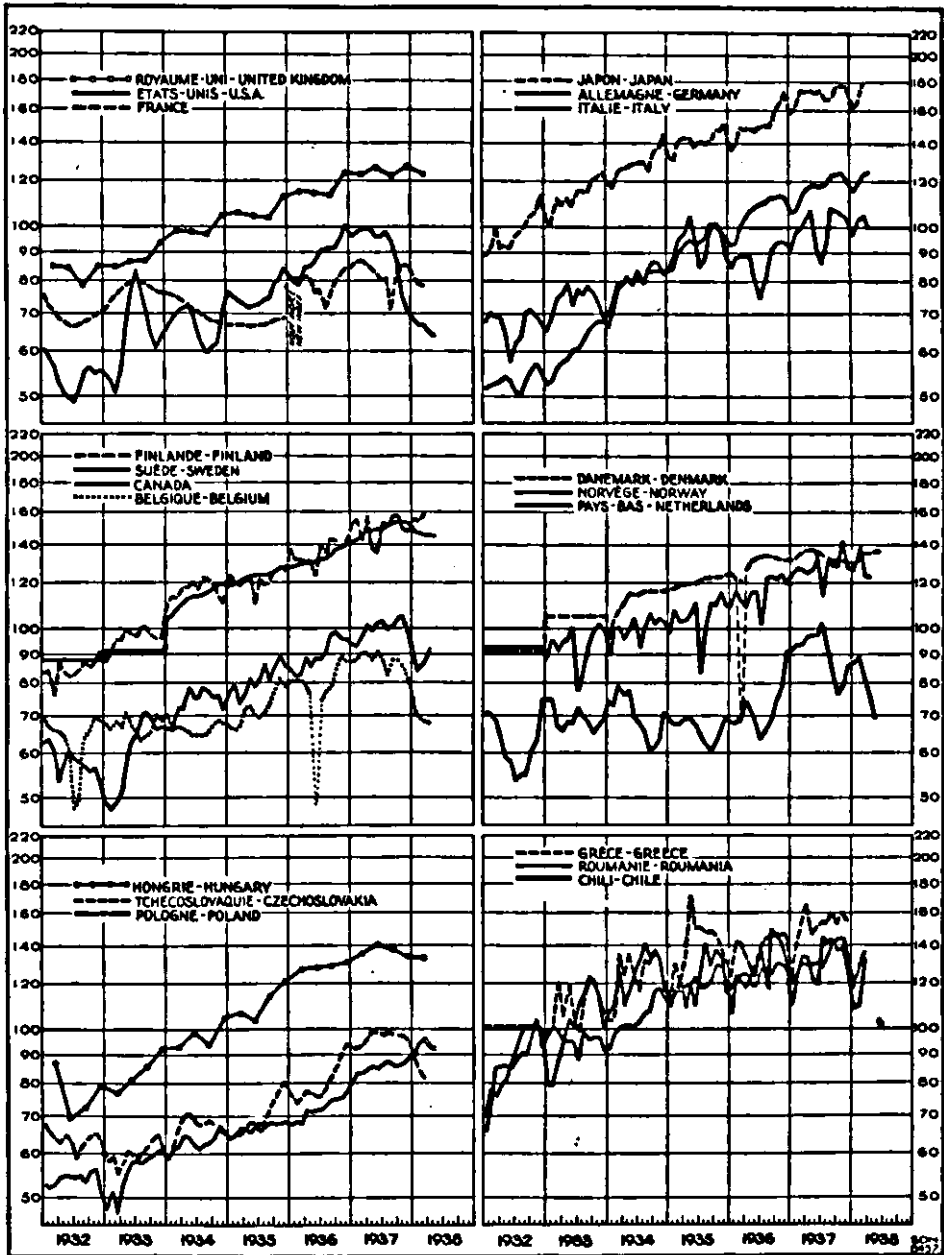
The graph on page 71 shows the movements of industrial production in a number of different countries since 1932. The almost universal recovery of production since the worst years of the depression in 1932 and 1933 is apparent. Only in the

¹ Cf. the graph on page 14 of Chapter I.

² Cf. League of Nations: *World Production and Prices, 1937/38*, Chapter I, Diagram 9.

Industrial Production in Certain Countries.

(1929 = 100.)



countries of the old gold *bloc* was recovery seriously delayed. In France, when allowance has been made for the change in the index of production at the beginning of 1936, there appears to have been no substantial recovery since 1932; and in the Netherlands, recovery was delayed until the abandonment of the gold standard in 1936. But while there was an almost universal increase in production between 1932 and 1937, there were wide divergences in the level of production attained. In the Union of Soviet Socialist Republics, which is not shown in the graph, production in 1937, after a period of remarkably rapid industrialisation, was as much as 324% higher than in 1929. Considerable increase occurred during 1937, though in some industries there was for the first time a failure to achieve increases as great as those which had been planned. At the other extreme is France, where production in 1937 remained some 17% below the 1929 level. In making such comparisons, it must be remembered that different countries enjoyed very different degrees of prosperity in 1929. In the case of France, 1929 was a year of great prosperity, whereas the United Kingdom, for example, by 1929 had already been adopting a deflationary policy for four years, since the return to the gold standard in 1925, and already had over a million workers unemployed.

The graph on page 71 also shows clearly the change in trend which occurred in many countries during 1937. In the United States, a very rapid fall in production is apparent; and serious declines occurred also in Canada, Belgium, Czechoslovakia and the Netherlands. Other countries, such as Sweden and Hungary, experienced more moderate declines. In yet other countries, of which the United Kingdom is an outstanding example, little, if any, absolute decline occurred, but the upward movement ceased. In certain countries, including some with rigidly controlled economic systems, such as Germany and Italy, the upward movement continued. This was true also of Japan, where the expansion of production appears to have slowed down, in spite of the war activity of the heavy industries. This was probably due in the main to the difficulties in obtaining raw materials for light industry working for the home and for export markets, and also to the fall in the demand in export markets as a result of the depression and of unofficial boycotts.

In many countries, expenditure on building comprises a large part of the total value of new capital construction. In some countries, such as the United Kingdom, the recent recovery has been largely due to a rapid expansion of building activity, whereas in others, such as the United States, the failure of building to recover has been one of the important causes of

failure to regain the 1929 level of business activity. The following table shows recent changes in building activity in a few important countries:

*Total Building Activity in Certain Important Countries,
by Quarters.*
(1929 = 100.)

Stage of Construction.

A Buildings completed. B Permits granted. C Contracts awarded.

System of Measurement.

Country	Scope of figures	System of Measurement			First quarter	
		1935	1936	1937	1937	1938
Union of South Africa ^a .	A.I.	217.8	251.3	279.8	291.9 ^b	323.2 ^b
Argentina (Buenos Aires)	B.V.	48.3	44.0	58.2	52.6	67.1
Australia	B.VII.	66.9	80.2	89.3	70.0 ^c	85.2 ^c
Belgium	B.VII.	99.5	92.4	85.8	78.7 ^b	70.8 ^b
Canada	C.I.	24.9	25.0	38.0	24.3	17.8
Chile	B.V.	139.6	120.1	139.1	84.8 ^a	138.6 ^c
Czechoslovakia	A.IV.	43.7	68.4	72.3	38.4 ^c	55.3 ^c
France	B.VII.	55.7	52.8	46.3	53.4	40.1
Germany	A.IX.	67.6	98.8	101.1	72.6	62.5
Hungary (Budapest).	A.IV.	52.2	92.0	84.6	47.2 ^b	80.0 ^b
Italy	B.VIII.	119.2	60.0	65.8	66.9	59.5
Netherlands	A.VI.	95.5	63.9	61.5	40.2	57.5
New Zealand	B.VIII.	66.6	72.2	84.1	68.6 ^b	75.6 ^b
Poland ^d	A.III.	121.8	151.1	202.8	114.5	...
Sweden	A.IV.	149.8	166.5	167.0	145.8	139.7
Switzerland	A.VI.	44.9	29.4	58.8	49.0	66.9
United Kingdom	B.I.	156.4	160.1	151.8	159.1	138.9
United States	C.II.	31.9	51.8	56.4	53.0	36.7

^a Base: 1932 = 100. ^b January and February. ^c January only.
^d Base: 1931 = 100.

The table brings out clearly the very great changes that have taken place in building activity since 1929 and the very diverse experience of different countries. The figures suggest that the building boom in some countries, such as the United Kingdom and Sweden, may have reached or passed its peak. In the United States, by the middle of 1937, some noticeable recovery in building had been achieved from the very low levels reached in 1932, 1933 and 1934; but in the last quarter of 1937 and the

first two months of 1938, there was again a serious decline. The figures for March 1938, however, showed a considerable recovery,¹ which may have been due in part to the Housing Act to which reference has been made on page 23 of Chapter I.

INDUSTRIAL PRODUCTION AND THE DEMAND FOR LABOUR AND RAW MATERIALS ²

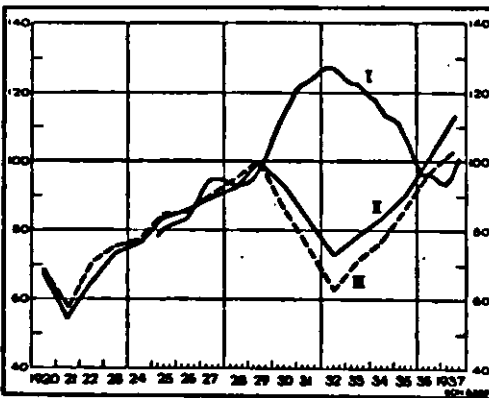
In the previous chapter, recent changes in the demand for labour have been examined, and an earlier section of this chapter has been devoted to changes in the demand for raw materials. In this section, an attempt is made to relate these changes to recent movements in the volume of industrial production.

The graph below makes clear the close connection between the volume of manufacturing and the markets for raw materials.

Manufacturing and the Demand for Raw Materials.

(1929 = 100.)

- I Stocks of raw materials.
- II Production of raw materials.
- III Manufacturing (excluding the U.S.S.R.).



Between 1925 and 1929, the world indices of manufacturing and of the production and stocks of raw materials all increased at much the same rate, which suggests that a certain measure of balance had been obtained between the primary production of raw materials and secondary production of manufactured goods. From 1929 to 1932, manufacturing fell off more rapidly than raw-material production, and in consequence stocks of raw materials were accumulated. From 1932 to 1937, both primary and secondary production recovered; and until 1936, secondary production increased more rapidly than

primary production. As a result of this and of the fact that manufacturers' stocks³ of raw materials were replenished during the period of recovery, stocks fell as rapidly as they had previously risen.

¹ The index rose from 28.9 to 52.

² Cf. League of Nations: *World Production and Prices, 1937/38*, Chapters I and II.

³ The index of stocks does not include manufacturers' stocks.

There is an equally close connection between the level of industrial production and the demand for labour, as is shown by the following graph:

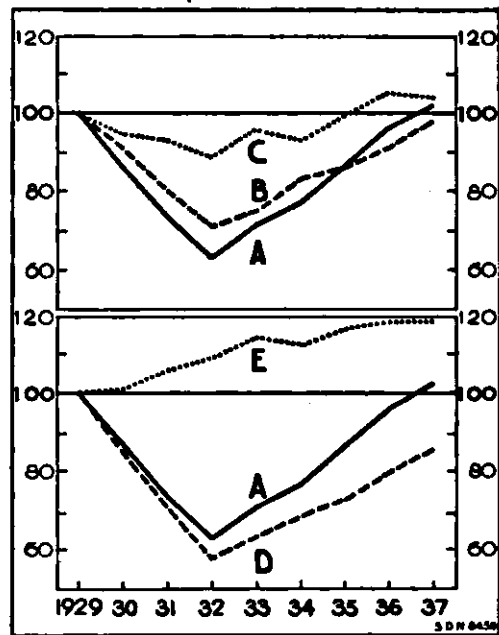
The first part of the graph shows that the reduced demand for goods during the depression from 1929 to 1932 gave rise to a fall in industrial production, which was accompanied by a fall in the demand for labour; and as the recovery developed from 1933 to 1937, both industrial production and the number of men employed rose towards the 1929 level. If the figures for industrial production are divided by the number of workers in employment, an index of output per man is obtained. It appears that production at first fell, and later rose, more rapidly than the number of persons employed, with the result that output per man fell during the development of the depression and rose again with the recovery of production.

This is at first sight surprising. For it might have been expected that, as the depression deepened, the less productive plant and the less efficient concerns would have been closed before the more efficient, and that, in consequence, the productivity of labour would have risen as total output was reduced. In fact, as the second part of the graph shows, labour productivity did rise, in spite of the fall in output per man. During the depression, as has already been explained in the previous chapter, the hours worked by each man were reduced, as workers were put on short time and as other measures were taken to spread the available amount of work among as many workers as possible. In the second part of the graph, fluctuations in industrial production

Industrial Production, Employment and Labour Productivity.

(1929 = 100.)

- A Industrial production.^a
- B Number of men employed.^b
- C Output per man.
- D Aggregate hours worked.^b
- E Output per man-hour.



^a League of Nations index of industrial production, including mining.

^b International Labour Office index recalculated on the basis of the weights of the production index.

are compared with the total number of hours worked instead of with the total number of workers employed; and from this it is clear that industrial production at first fell less rapidly, and later rose more rapidly, than the aggregate number of hours worked. In consequence, with the exception of the year 1934, output per man-hour rose each year from 1929 to 1937; and in 1936 and 1937 was about 18% greater than in 1929. The fact that labour productivity, measured in this way, rose throughout the period may be ascribed to the continuous rationalisation and technical improvement of industry. But, as may be seen from the graph, output per man-hour rose most rapidly between 1930 and 1933; and this may be explained by the closing-down of the least efficient units of production during the depression.

Chapter IV

PRICES ¹

THE DECLINE IN COMMODITY PRICES

The year 1937 witnessed a remarkable change in the trend of commodity prices. From the autumn of 1936 until the spring of 1937, there was a period of rapidly rising prices for primary products. The recovery of industrial production and the intensification of rearmament expenditure in many countries had increased the demand for raw materials, until the point was reached at which real shortages of such materials were anticipated in spite of the relaxation of many restriction schemes controlling their production and export.² At this point, in view of the fear of future shortages, a speculative demand for commodities developed and was superimposed upon the high normal demand. In the early months of 1937, however, it was realised that supplies were being increased to meet the demand more readily than had been expected; and, at the same time, certain additional factors operated to break the speculative boom in prices. President Roosevelt stated that raw-material prices were unduly high; it was persistently rumoured that the dollar price of gold was to be reduced as a method of controlling the inflationary rise in prices; and in April 1937 the new National Defence Contribution was introduced in the British Budget in a form which was expected to have adverse reactions on business enterprise. These and similar events intensified and hastened a collapse in commodity prices which was essentially due to the previous under-estimation of the sufficiency of supplies to meet the growing demand. After the sharp fall in commodity prices occasioned by the break in the speculative boom, raw-material prices continued to fall as a result of the decline in industrial activity in the United States and of the gradual spread of this recession to other countries.

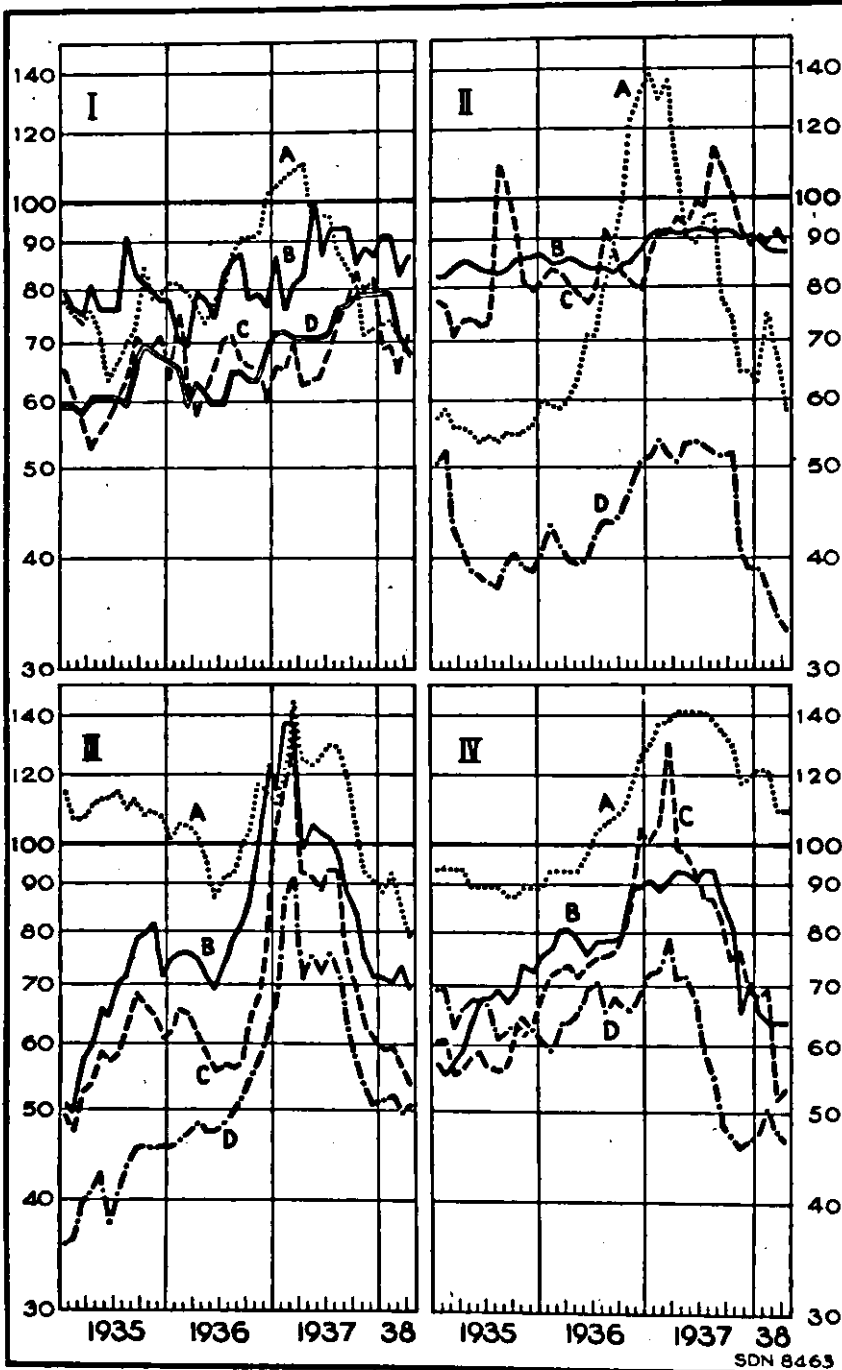
The graph on page 78 shows monthly movements since 1935 in the prices of some of the most important primary products.

¹ Cf. League of Nations, *World Production and Prices, 1937/38*, Chapter VI, for the more detailed information, on which this chapter is based.

² Cf. Chapter VIII.

Prices of Primary Products.*
(1929 = 100.)

- | | | | |
|---|--|---|---|
| <p>I.
 A Wheat.
 B Beef.
 C Butter.
 D Rice.</p> | <p>II.
 A Cocoa.
 B Sugar.
 C Tea.
 D Coffee.</p> | <p>III.
 A Tin.
 B Lead.
 C Zinc.
 D Copper.</p> | <p>IV.
 A Timber.
 B Wool.
 C Rubber.
 D Cotton.</p> |
|---|--|---|---|



* Sterling prices quoted in London, except coffee (New York), timber (Sweden) and wheat (Chicago).

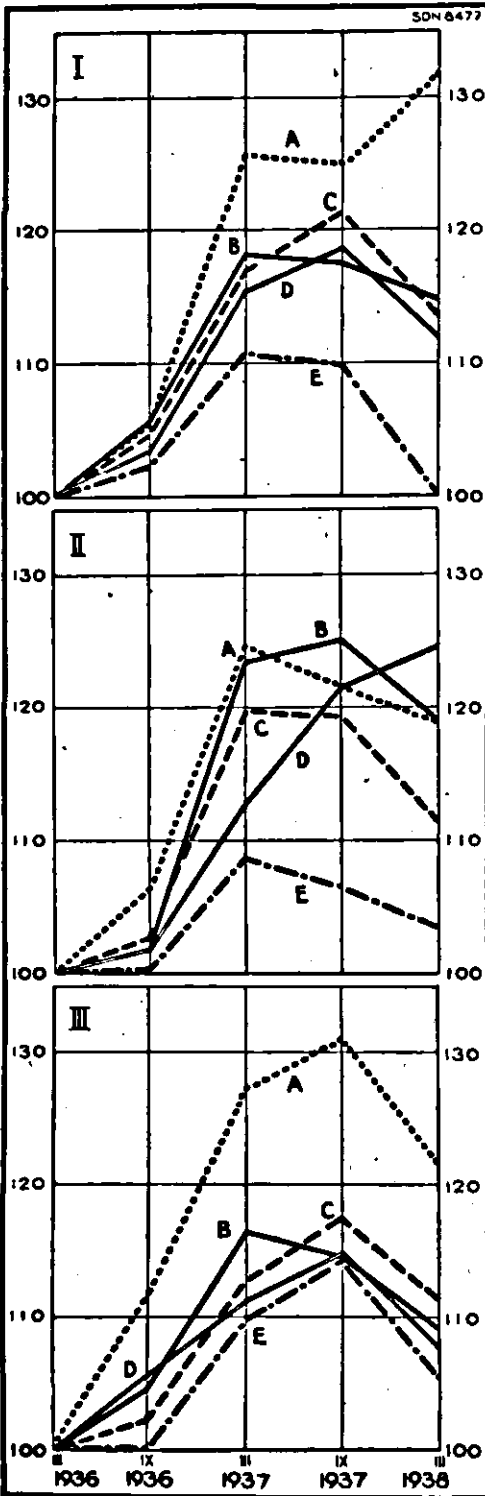
It can easily be seen from the graph that the rapid rise in prices until the spring of 1937 and the subsequent rapid fall were much more clearly marked in the case of raw materials (shown in sections III and IV of the graph) than in the case of foodstuffs (shown in sections I and II). In the case of many foodstuffs, there has been little fall, or even an actual rise, in price since the spring of 1937, whereas there have been very substantial and dramatic price reductions in the case of all the raw materials illustrated in the graph. Three of the foodstuffs — wheat, coffee and cocoa — have experienced substantial price reductions since the spring of 1937; but these price movements were largely due to special factors affecting the supply of the particular commodities. In the case of wheat, the large 1937 crop in the United States, following a series of poor harvests, had a depressing influence on the price. The failure of a Pan-American Conference of coffee-producing States in August 1937 to agree on a restriction scheme was followed in November by the relaxation of the Brazilian scheme of restriction of her coffee exports;¹ and the consequent increase in coffee supplies was the main cause of the slump in coffee prices. During the last half of 1936, cocoa prices rose as a result of rumours of a shortage of supplies; but the subsequent fall in price was due, not only to a correction of the market situation, but also to a decline in demand.

The decline in raw-material prices since the spring of 1937 has been almost entirely due to changes in demand. In the first place, the speculative demand disappeared; and later the industrial recession in the United States caused a very marked reduction in the world demand for raw materials. The quantities of certain raw materials consumed in the United States showed the following percentage falls between January 1937 and January 1938:

	%		%
Wood pulp	23.7	Rubber	41.9
Silk	30.7	Tin	60.0
Cotton	35.9	Wool	60.6

When it is realised that in 1936, for example, the United States accounted for more than half of world consumption in the case of rubber, about a third in the case of copper, slightly less than a third in the case of lead, and nearly half in the case of tin, the direct effect of the American recession on raw-material prices can be appreciated. Subsequently, the decline in industrial activity in other countries has accentuated the fall in

¹ Cf. Chapter VIII.



Wholesale Prices.
March 1936 = 100.

I.

- A Japan.
- B Canada.
- C United Kingdom.
- D Sweden.
- E United States.

II.

- A Switzerland.
- B Netherlands.
- C Belgium.
- D Italy.
- E Czechoslovakia.

III.

- A Chile.
- B Poland.
- C Argentine.
- D Australia.
- E India.

commodity prices. While recent price movements in the case of most raw materials have been determined by the changes in industrial demand, cotton prices have fallen mainly as a result of the record harvest in the United States, which has greatly increased available supplies.

These movements in commodity prices are reflected in the changes of wholesale prices in the different countries. The graph on page 80 shows the changes in wholesale prices in fifteen countries during four half-yearly periods since March 1936. The movements in wholesale prices were fairly uniform between March 1936 and March 1937. From March to September 1936 there was a moderate rise in prices in nearly all countries, which gave place to a very rapid rise in prices between September 1936 and March 1937 during the period of speculative demand for commodities examined above. During this period there was a considerable rise in prices in the countries which devalued their currencies in the autumn of 1936, some of which are represented in section II of the graph; but it is clear that the sharp rise in prices was by no means confined to these countries. Between March and September 1937 there were greater divergences of price movements; and comparatively moderate price rises occurred in eight of the countries shown in the graph, while price falls occurred in the other seven countries. With the onset of the American recession in the autumn of 1937, marked reductions of wholesale prices occurred in all countries shown in the graph with the exception of Japan and Italy; and the fall in prices was particularly heavy in the United States, which is the only country in which the price level in March 1938 had fallen as low as at March 1936.

In the case of France and Germany, which are not included in the graph on page 80, special factors have influenced the movement of prices. In France, for the reasons discussed in Chapter I, the rise in prices has been much greater than in any of the countries shown in the graph on page 80, as the following figures show:

French Wholesale Prices.

(March 1936 = 100.)

1936 September	March	1937 September	1938 March
116.7	146.2	167.5	168.5

This rise in French prices occurred as a result both of the continued depreciation of the franc, which directly raised the price of imported goods, and also of the rise in internal

costs, which has affected the price of home-produced goods. The operation of these two factors is illustrated by the following figures:

Percentage Change in French Wholesale Prices.

	March 1936 to Sept. 1936	Sept. 1936 to March 1937	March 1937 to Sept. 1937	Sept. 1937 to March 1938
All products	+ 7	+ 32	+ 15	+ 0.2
National products.	+ 10	+ 21	+ 14	+ 4
Imported products	+ 3	+ 59	+ 17	- 7
Franc price of £ sterling	+ 2	+ 38	+ 32	+ 14

Between September 1936 and March 1937, French prices of imported products rose by 59% as a result of a 38% depreciation of the franc imposed upon a serious rise in world prices; but during this period the prices of home-produced commodities rose by only 21%. From March to September 1937, as a result of declining world prices, the price of imported products rose less than the depreciation of the franc; and between September 1937 and March 1938, world prices fell so rapidly that the price of imported products actually declined by 7% in spite of a further depreciation of 14%. Except for the period March to September 1936, during which the franc depreciated only very slightly, the average rise in price of home-produced commodities and indeed of all products was less than the depreciation of the franc; and this suggests that the disequilibrium which had arisen between French and world prices as a result of the French adherence to the gold standard was in the process of disappearing.¹

In the case of Germany, as a result of the strict control of prices and costs, practically no fluctuations have occurred in the general level of wholesale prices, although variations have occurred in individual prices of the different groups of commodities composing the general index. In March 1937, the general index of wholesale prices was 2.4%, and in March 1938 2.1%, above the level of March 1936.

In addition to these movements in commodity prices, similar movements have occurred in other prices. For example, prices of industrial shares in many countries rose to a peak during 1937 and have subsequently declined, as will be seen in Chapter V. As the following figures show, ocean freight rates have also moved in a similar way:

¹ Cf. Chapter VII, pages 154-156.

*United Kingdom: Ocean Freight Rates.**

(1929 = 100.)

	1936	1937	1938
March	79.6	122.1	102.3
June	80.3	139.1	...
September	88.9	150.4	...
December	113.6	112.0	...

* *Economist* Total Index.

The process of economic recovery and of increasing demand for goods and services led to a rapid increase in the quantum of world trade during the second half of 1936 and the first half of 1937;¹ and this, together with the scrapping of obsolete ships in previous years, gave rise to a real scarcity of shipping facilities, with the result that freight rates rose rapidly. But, with the recent fall in the quantum of world trade, freight rates have again declined.

Changes in Price Relationships.

Price movements are of great importance if prices do not all move in the same way. If, for example, a producer finds that the selling price of his product has declined, but that at the same time an exactly similar fall has occurred in the prices of raw materials, of labour, of capital goods and of the commodities and services which he himself consumes, no change will have occurred in his real economic condition except in so far as he must meet debts whose money value has been fixed by a long period contract. But changes of real economic significance occur when the price which a producer can obtain for his product rises or falls in relation to the prices which he must pay for the goods and services which he purchases for his own consumption or to carry on with his production. It is for this reason that, in examining price movements, emphasis must be laid on changes in the relations between different prices.

In the process of the change from recovery to renewed recession in a number of countries during 1937, some typical changes have occurred in price relationships. Some of these changes are illustrated in the graphs on pages 84 and 85.

¹ Cf. Chapter VI.

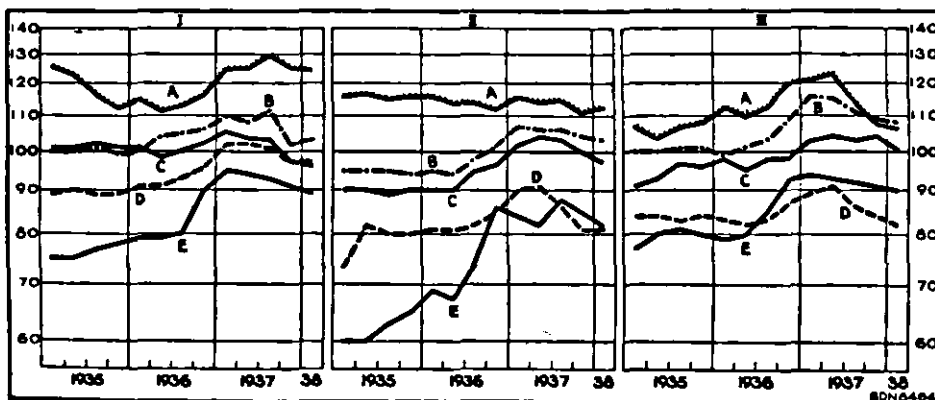
As a general rule, movements in retail prices are smaller than, and lag behind, changes in wholesale prices. Goods at retail often have more or less stable conventional prices, whereas wholesale prices are usually fixed in keenly competitive markets. Moreover, retail prices contain a larger proportion of relatively stable cost elements — such as wages — than do wholesale prices. Finally, changes in prices of raw materials and in wages take some time before they are passed on to the stage of retail distribution. The graph on this page illustrates these relations. During the period of rapidly increasing demand and rising prices from the autumn of 1936 to the spring of 1937, wholesale prices rose in relation to the cost of living; and, in the subsequent period of falling demand and declining prices, the movement of the price relationship has been reversed.

Another most important price relationship which is much influenced by changes in the general level of trade activity is the relation between agricultural and non-agricultural prices. When the general level of demand falls, the output of farm products is reduced only slowly and to a very limited extent, and in consequence agricultural prices fall very severely. On the other hand, industrial production is so organised that, when demand falls off, workers are dismissed and production is curtailed so that prices are maintained at relatively high levels. In consequence, the ratio of agricultural to non-agricultural

Ratio of Wholesale Prices to Cost of Living.

(1929 = 100.)

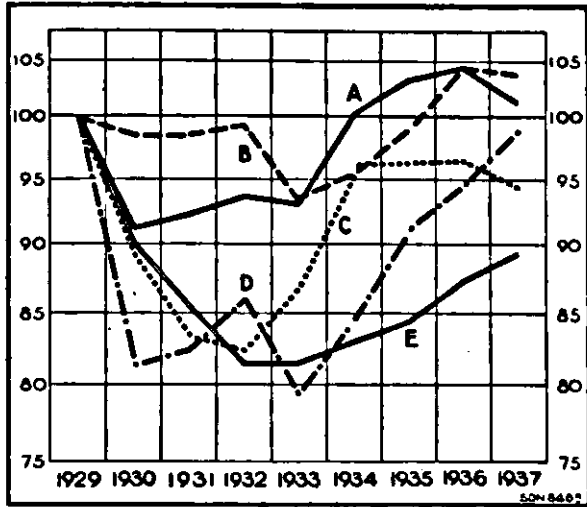
- | | | |
|-------------------|------------|-------------------|
| I. | II. | III. |
| A Argentine. | A Peru. | A Roumania. |
| B Australia. | B Canada. | B Japan. |
| C United States. | C Sweden. | C Italy. |
| D United Kingdom. | D Belgium. | D Czechoslovakia. |
| E Netherlands. | E France. | E Switzerland. |



Ratio of Price of Food-stuffs to Price of Manufactured Goods.

(1929 = 100.)

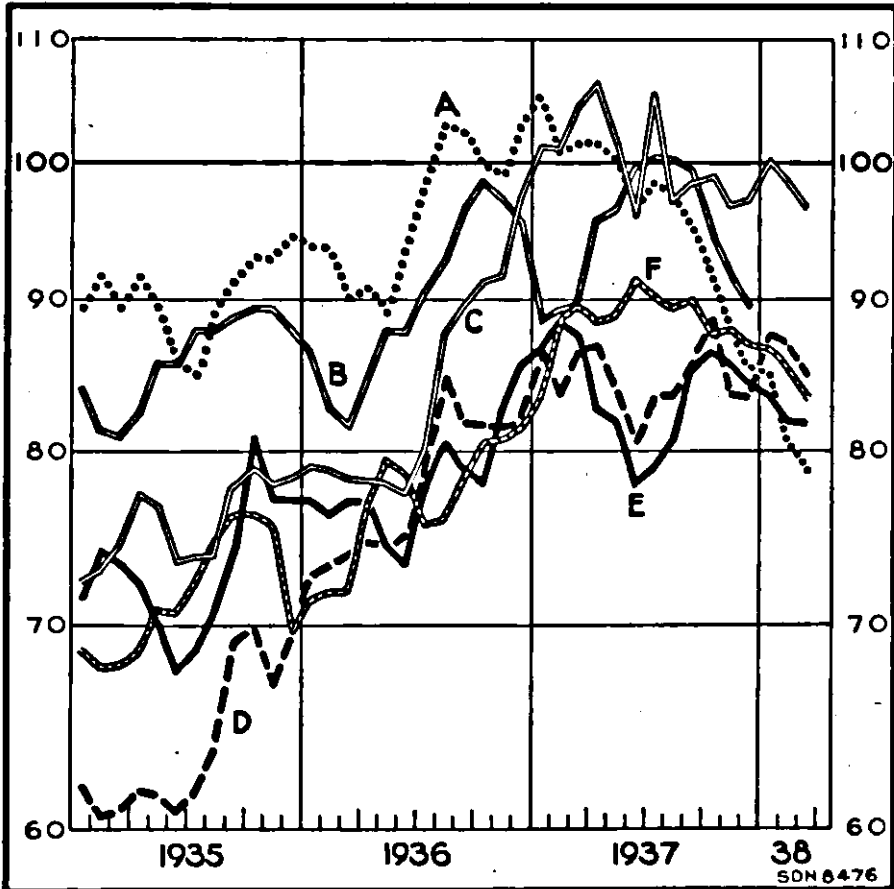
- A Germany.
- B Italy.
- C Netherlands.
- D Belgium.
- E World Market.



Ratio of Agricultural to Non-agricultural Prices.

(1929 = 100.)

- | | |
|------------------|--------------|
| A United States. | D Argentine. |
| B Chile. | E Estonia. |
| C Canada. | F Poland. |



prices tends to turn against the farmers in times of depression and to move again in their favour during periods of good trade. This relationship is illustrated by the graph on page 85 showing the relation between the prices of foodstuffs and of manufactured goods since 1929. The price ratio on the world market¹ moved to the advantage of manufacturers during the deepening of the depression from 1929 to 1932, and subsequently, with the recovery from 1933 and 1937, moved back to the advantage of food producers. The fact that the price ratio in 1937 was more favourable to food producers in the four national markets shown on the graph than in the world market is to be explained by the policies of agricultural protection which were adopted or extended at various dates between 1929 and 1937. More recent variations in the ratio between agricultural and non-agricultural prices are shown in the second graph on page 85. From 1935 to the beginning of 1937, the price ratio moved in favour of agricultural products; but, since that date, the onset of a new recession has again caused the price ratio in many countries to move to the disadvantage of agriculture. This recent movement has been most marked in the United States, where the large crops of wheat, maize and cotton have brought about a serious fall in agricultural prices.

A particularly important way in which the changed relation between agricultural and non-agricultural prices shows itself will be discussed later in Chapter VI. The industrialised countries rely upon the export of manufactured products for the purchase of necessary raw materials and foodstuffs, while countries producing primary products export raw materials and foodstuffs in return for manufactured imports. The terms of international trade move, therefore, to the disadvantage of the countries producing primary products, when the prices which they can obtain for their exports of such products fall in relation to the prices which they must pay for imported manufactures. The graph on page 120 of Chapter VI shows how recent changes in price relationships have moved the terms of international trade to the disadvantage of the primary producers after a gradual movement in their favour back towards the pre-depression level.

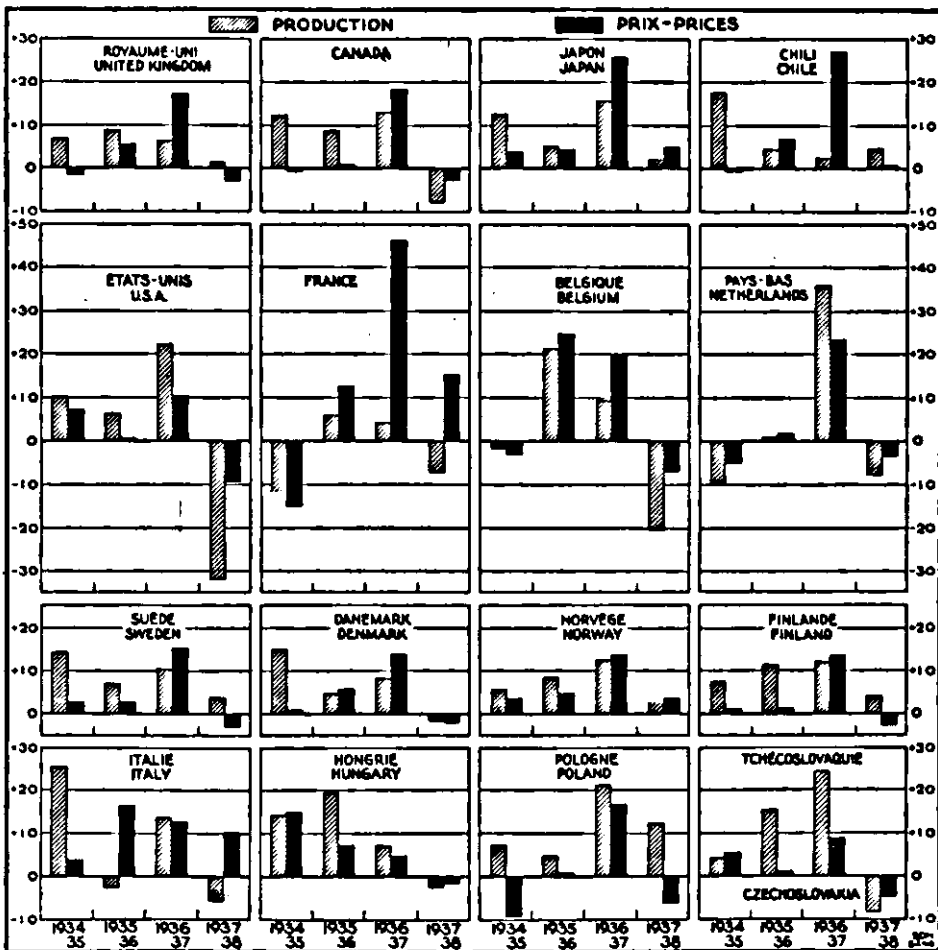
SELLING PRICES AND COSTS

Perhaps the most important price relationship is that between selling prices of finished commodities and the prices of the factors of production, such as labour and capital, by means of

¹ This ratio is calculated from the prices of foodstuffs and of manufactured goods entering into world trade.

which production is effected. In most modern economic systems, the prices of the factors of production, and in particular the wages paid to labour, are less flexible and move more slowly than commodity prices. An increase in the general level of demand for goods and services usually causes a rise in the prices offered for commodities; and, since the prices of the factors of production do not rise so much or so quickly, the profit margin is increased and production and employment are extended. For this reason, a rise in commodity prices usually raises, and a fall usually lowers, the volume of production.

Annual Percentage Increase or Decrease in Industrial Production^a and Wholesale Prices.^b



^a Changes in production between the first quarter of one year and the first quarter of the next year.
^b Changes in prices between March of one year and March of the next year.

The graph on page 87, illustrating the changes in wholesale prices and in production in sixteen countries during the last four years, shows the close connection between prices and production.¹

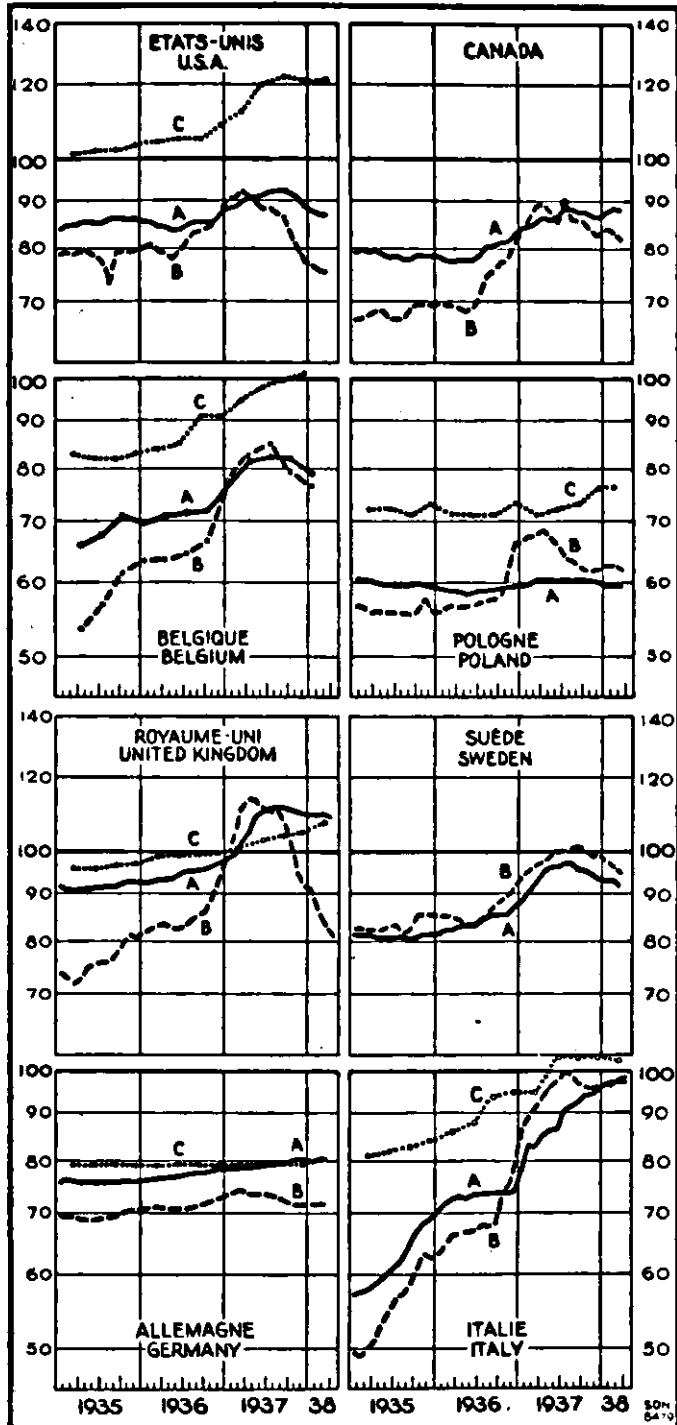
In a number of countries — such as Canada, Finland, Japan, Norway, Sweden and the United Kingdom — the rise in prices in 1936 was much greater in relation to the rise in production than in the previous two years. This may be explained in part by the fact that these countries had already reached an advanced stage of economic recovery when productive capacity was already in active use, so that further increases in monetary demand gave rise to increased prices rather than to increased output. In five countries — the United States, Italy, Poland, Czechoslovakia and the Netherlands — in which production was still substantially below the 1929 level, the increase in production in 1936 was greater than the rise in prices. In 1937 there were considerable divergencies in the behaviour of the different countries. In six cases — Canada, the United States, Belgium, Netherlands, Denmark and Czechoslovakia — both prices and production fell. In the case of four countries — the United Kingdom, Sweden, Finland and Poland — production continued to rise in spite of a fall in prices; but, in all these cases, the increases in production were considerably smaller than during the previous year of rising prices. In France and Italy, production fell, although prices continued to rise. The peculiar difficulties which led to the restriction of production in France have already been discussed at some length in Chapter I.

Changes in wholesale prices reflect changes in raw-material prices as well as changes in the selling prices of finished goods. In order to examine more fully the relations between selling prices and costs, it is important to distinguish between the prices of finished commodities and the prices of raw materials, which, together with the wages of labour, constitute the main items of variable costs of production. This comparison between selling prices on the one hand and raw-material prices and wage rates on the other is made on the graph on page 89 for eight countries, for which separate price indices of finished goods and of raw materials are available.

¹ Too much importance should not be attached to these relations as the indices of wholesale prices in many cases are affected by prices of raw materials, foodstuffs and imported goods, while the production indices refer only to domestic industrial production.

Selling Prices and Industrial Costs.
(1929 = 100.)

- A Prices of finished goods.*
- B Prices of raw materials.*
- C Wage rates.



* United Kingdom: January 1930 = 100.

In all the countries shown in the graph, raw-material prices rose relatively to the prices of finished goods during the last months of 1936 and the first months of 1937. This period was one in which raw-material prices were being raised by the increased demand on the part of speculators as well as on the part of producers. In consequence, raw-material costs probably rose more rapidly and to a higher level than could be justified solely by the increased demand for finished products. These price movements reduced the margin of profit obtainable on each unit of finished product; and this, by reducing the prospect of profit, probably reduced the incentive of producers to embark on capital extensions, and may thus have contributed to the recession in business activity in the course of 1937.

At the same time, there was a considerable rise in money wage-rates in a number of countries; and, as the graph shows, the rise in wage rates in relation to selling prices was particularly marked in the United States. This, again, was a factor tending to reduce the profit margin and the prospect of profit and may have had serious adverse effects upon the willingness of entrepreneurs to embark upon extensions of their capital equipment. In the United Kingdom during the first half of 1937, the price of finished commodities rose more rapidly than wage rates; but the rise in wage rates has continued since then in spite of a fall in selling prices. In a number of other countries, many of which are not shown on the graph on page 89, there were considerable rises in money wage-rates during 1937; and these rises have already been discussed at some length in Chapter II.

Chapter V

MONEY AND FINANCE

THE SUPPLY OF MONEY

In recent years, the supply of money has been plentiful in the majority of countries; and conditions in the money and capital markets have remained comparatively easy in spite of the rapid progress of industrial recovery, which, by increasing the demand for liquid funds, might have been expected to cause a considerable rise in interest rates. The following figures show that the total supply of money in most countries except those of Central and Eastern Europe was greater in 1937 than in 1929.

In every country shown in the table except Switzerland, there has been a considerable increase in the supply of money since 1933; and, in every country except the United States of America, the supply of money increased between 1936 and 1937.

*Volume of Money.*¹
(1929 = 100.)

Countries	1933	1936	1937
Japan	94	117	131
United Kingdom	107	123	124
Sweden	104	116	123
United States	79	114	112
Belgium	92	109	...
France	101	105	110
Australia	89	100	108
Argentine	87	100	106
Switzerland	99	94	99*
Czechoslovakia	89	91	...
Hungary	81	86	93
Italy	80	85	93*
Germany	69	78	84*
Poland	71	77	83
Roumania	69	74*	83*

* Based on provisional figures.

¹ Including coin, notes and total deposits, and excluding the cash reserves of the commercial banks.

It is of interest to analyse the causes of the increases in monetary supplies between 1929 and 1937. The supply of money depends primarily upon the gold reserves of the central banks; for it is on the basis of these reserves that notes are issued and cash reserves are made available to the commercial banks. But central-bank reserve ratios must also be taken into account, since an increase in the ratio of central-bank reserves to liabilities will tend to offset an increase in the supply of gold. Similarly, the cash reserve ratios maintained by the commercial banks against their deposit liabilities must be considered, since an increase in these reserve ratios will tend to restrict the volume of deposit money. Another factor of some importance is the public's choice between cash and deposits; for, if the public determines to hold a larger proportion of cash to deposits, cash will be drawn from the commercial banks and these banks may be obliged to restrict the supply of deposits in order to prevent a fall in their cash reserve ratios.¹

By far the most important factor affecting the supply of money since 1929 is the large increase in the value of central-bank gold reserves. This increase has two explanations. The devaluation of nearly all currencies since 1929 has raised the price of gold in terms of national currencies; and, largely as a result of this, the production of gold has increased considerably, as the following figures show:

*World Production of Gold.**

Kilogrammes.

	South Africa	United States of America	Canada	Other countries	Total ^a
1929	323,860	64,042	59,977	162,121	610,000
1936	352,596	117,668	116,577	443,159	1,030,000
1937	364,986	126,215	127,396	481,403	1,100,000

^a Including the Union of Soviet Socialist Republics, for which actual figures are not available, but which is assumed to have produced 30,000 kilogrammes in 1929 and 180,000 kilogrammes in 1937.

¹ There are a number of other factors of secondary importance which affect the supply of money, such as the amount and form of monetary reserves held by Governments, the distribution of the commercial-bank reserves between notes and balances at the central bank, the distribution of the public's holdings of cash between notes and coins and of the public's holdings of deposits between time and sight deposits. These factors are omitted from the discussion.

² *Statistical Year-Book of the League of Nations, 1937/38.*

The price of gold in terms of the national currencies of the gold-producing countries was some 76% higher in 1937 than in 1929;¹ and, since the level of wholesale prices of other commodities in the same group of countries fell by about 15% between 1929 and 1936, there has been a great stimulus to the production of gold. In addition to this increase in the quantity of gold, gold reserves in many countries — including the United States, Belgium, France and Switzerland — have been revalued at a higher price in terms of national currencies, so that the same quantity of gold can serve as base for a greater monetary circulation. In other countries, such as the United Kingdom, the Netherlands and the Scandinavian countries, there has been no revaluation of central-bank gold reserves, which have therefore been affected only by changes in the quantity of gold.

In a number of cases, a part or the whole of the gold released by its revaluation at a higher price was allocated to exchange equalisation funds, as in the United States, Belgium, France and Switzerland; and this part of the increased value of gold reserves was thus sterilised and did not raise central-bank reserves. In the United States, moreover, a large part of the additional gold reserves since the end of 1936 were paid into an inactive gold fund, as can be seen from the graph on page 97; and this gold was not, until recently, added to the reserves of the Federal Reserve banks. In addition to this, there has been a considerable hoarding of gold since 1931 by private persons in Western countries as a result of the fear of depreciations of the gold value of national currencies.²

In spite of these different factors leading to the sterilisation of gold, there have, in a majority of countries, been considerable increases in the value of monetary gold reserves since 1929, as the following figures show:

¹ League of Nations: *Money and Banking, 1937/38*, Volume I, page 10.

² It has been estimated (*cf.* League of Nations, *Money and Banking, 1937/38*, Volume I, page 13) that, between December 1930 and September 1937, \$3,274 million of gold — valued at the old gold content of the dollar — were added to published official reserves, \$346 million of gold were used for industrial purposes, and \$1,681 million were absorbed into undisclosed official holdings, such as exchange equalisation funds, or into private hoards in Western countries. Of this total, \$3,373 million of gold were produced from the mines outside the Union of Soviet Socialist Republics, \$338 million were received from the Union of Soviet Socialist Republics, and the remaining \$1,590 million were obtained from dehoarding in Eastern countries and from the sale of gold coins, jewellery, etc., in Western countries to take advantage of the higher price of gold.

Value of Visible Gold Reserves at the End of 1937.

(End 1929 = 100.)

Countries	At 1929 price	As valued in central-bank accounts	At market price of gold
World *	140	—	237
Switzerland	333	450	470
United Kingdom } I	341	341	567
} II	224	224	370
United States	193	327	327
Netherlands	306	306	375
Belgium	216	300	300
Sweden	220	220	387
Czechoslovakia	146	208	208
Roumania	130	179	179
Poland	161	161	161
France	93	141	182
Japan	29	75	84
Hungary	52	52	52
Brazil	12	12	29 ^b
Germany	3	3	3

I. Bank of England gold reserves plus gold in the Exchange Equalisation Fund in September 1937.

II. Bank of England gold reserves.

- * Excluding the Union of Soviet Socialist Republics and Spain.
- ^b Value at free rate of exchange.

The first column of this table shows changes since 1929 in the quantity of gold reserves; the second column shows the change in the value of gold reserves after allowing for any revaluation of the gold in the central banks' accounts; and the third column shows the value which the gold reserves would have if they were revalued at the current market price of gold. World gold reserves have risen in quantity by 40% since 1929; and at current market prices in national currencies, weighted according to the distribution of gold reserves between different countries at the end of 1937, world gold reserves have increased by as much as 137% since 1929.¹

The following table illustrates the other important factors determining the total monetary supply. In many countries

¹ Recent changes in the gold reserves of different countries are shown in the graph on page 97, and are discussed in Chapter VII.

Countries	Central gold and foreign assets reserve ratios			Cash ratios of commercial banks			Ratio of net note circulation to total volume of money		
	1929	1936	1937	1929	1936	1937	1929	1936	1937
Chile . . .	^a 13.2	14.9	14.5	18.0	18.4	19.3	17.3	22.6	23.4
	^b 93.4	15.2	14.8						
France . . .	^a 47.4	59.1	53.4	15.8	21.1	...	51.5	64.0	...
	^b 77.0	60.5	54.2						
Germany . . .	^a 36.7	1.0	1.0	4.6	5.1	4.6	34.3	46.8	46.6
	^b 49.9	2.6	3.7						
Japan . . .	^a 47.2	22.8	27.6	11.3	7.6	8.6	8.3	9.0	9.4
	^b 58.5	25.0	29.3						
Netherlands	^a 49.9	65.2	84.1	6.9	11.5	21.1	26.4	29.7	24.0
	^b 74.5	65.4	84.4						
Sweden . . .	^a 29.0	35.6	30.6	3.7	12.1	15.3	12.9	17.1	17.6
	^b 60.5	83.8	86.5						
Switzerland	^a 49.6	98.1	85.1	2.7	10.9	...	6.8	10.7	...
	^b 79.0	100.1	100.7						
United Kingdom	^a 27.4	46.7	48.3	12.9	10.2	10.2	16.7	16.4	17.4
United States	^a 64.8	93.2	102.5	12.7	35.8	...	12.2	15.4	16.0

^a Gold reserves as a ratio of total note circulation and central-bank sight liabilities.
^b Gold reserves and foreign assets as a ratio of total note circulation and central-bank sight liabilities.

— notably France, the Netherlands, Switzerland, the United Kingdom and the United States — the gold reserve ratios of the central banks have risen since 1929, and this has tended to prevent the increased supplies of gold from exercising their full effect on the supply of money. In several countries, however, this rise in gold reserve ratios is due to the unwillingness of central banks to hold their reserves in the form of foreign assets, on which considerable losses were made during the period of currency depreciation which followed 1931. For example, in France, a rise in the gold reserve ratio since 1929 has not prevented a marked fall in the ratio of liabilities covered by gold and foreign assets combined. In a number of countries, the cash reserve ratios of the commercial banks have also risen considerably since 1929, partly as a result of the difficulty of finding suitable alternative uses for their funds and partly as a result of the desire to remain in a liquid position in order to avoid any repetition of the banking difficulties experienced in the crisis of 1931. Increases in the supply of money have also

been hindered by the public's increased preference for notes as opposed to deposits. In every country shown in the above table, the proportion of money held in the form of notes has risen between 1929 and 1937. A preference for cash developed during the period of banking difficulties between 1930 and 1933; and the continuation of this preference may be explained in part by the fall in interest rates which has caused commercial banks to offer lower rates of interest on deposits or to levy higher charges for banking services, and in part by the growing importance of retail as compared with wholesale trade, which has probably been caused in many countries by the growing "vertical integration" of processes of production and distribution.

The increase in the value of total gold supplies since 1929 has therefore been offset to a large extent by private hoarding of gold, by the payment of gold into exchange equalisation funds, by rises in the reserve ratios of central banks and of commercial banks, and by an increased preference for cash on the part of the public. For these reasons, there is at present a much greater liquidity in most banking systems than there was in 1929, and further increases in the supply of money could easily be permitted on the basis of existing gold reserves. But, as the table on page 91 shows, there are still a number of countries in which the supply of money is considerably below the 1929 level; and the main reason for this is the concentration of the increased gold reserves since 1929 in a few important creditor countries. A glance at the graph on page 97 is sufficient to show how disproportionately large a part of the available gold reserves is concentrated in a few countries; and the following figures show that the maldistribution of gold reserves was even more marked in 1937 than in 1929.

Percentage Share in Total Gold Reserves.

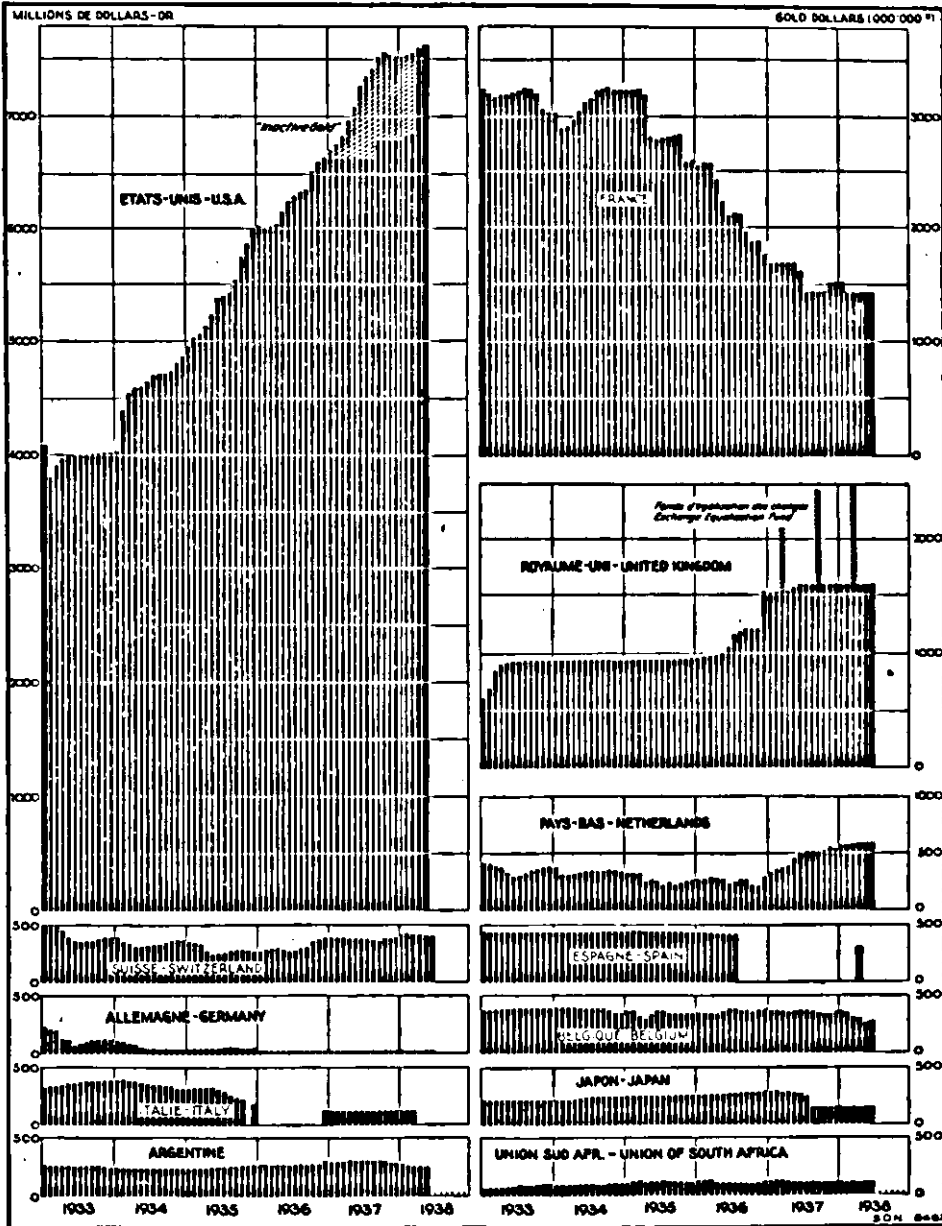
Countries	1929	1936	1937
United States	40	51	55
France	17	14	11
United Kingdom	7	12	12
Belgium, Netherlands, Switzerland	5	8	9
Thirteen "sterling" countries ^a . .	6	6	5
Germany, Italy, Japan	14	3	2
All other countries ^b	11	6	6
Total	100	100	100

^a Including Canada.

^b Excluding Spain and Union of Soviet Socialist Republics.

Central Monetary Gold Reserves of Certain Countries.

In old U.S.A. gold \$ (000,000's).¹



¹ Dollars of 1.50463 grammes of fine gold.

THE DEMAND FOR MONEY

The desire to hold money instead of other income-earning assets depends largely upon the volume of monetary transactions which needs to be financed. When business is brisk, many payments need to be made, and, for this reason, larger balances of cash or of deposits are normally held. But a larger volume of transactions can be financed with the same quantity of money, if people are willing to hold a smaller proportion of monetary balances to monetary transactions and to circulate their holdings of money at a higher velocity. This velocity of circulation of money may be affected by many different factors. For example, a rise in the rate of interest which can be earned on assets other than money may tempt people to hold a smaller amount of idle monetary balances in order to take advantage of the higher yields on other assets. On the other hand, such considerations as the expectation of rising commodity and security prices or an increased sense of security may induce people to invest money more promptly in goods and other assets; and such a rise in the velocity of circulation of money will be as effective as an increased quantity of money in increasing the demand for securities and in easing credit conditions.

The demand for notes depends mainly upon the activity of retail trade and upon the value of total wage payments, which are normally financed by cash payments; but there is evidence that note-hoarding has increased, and that the velocity of circulation of notes has fallen, in a great number of countries, since 1929.¹ In many countries in which the total volume of notes has increased considerably since 1929, notes of large denominations which are suitable for hoarding but unsuitable for the finance of retail trade now form a much larger proportion of the total note issue. This desire to hoard notes may be explained partly as a result of the fear of banking failures such as those experienced in the crisis years of 1930-1933 and partly as a result of the low interest rates which are now obtainable on deposits and other assets.

The relationships between the amount of deposit money, the volume of monetary transactions, the velocity of circulation of deposits, and interest rates are illustrated for nine countries in the graph ^a on page 99. In every country except

¹ Cf. League of Nations: *Money and Banking, 1937/38*, Volume I, pages 61 ff.

^a Except in the case of the United States, the figures for deposits include both sight and time deposits, so that an increase in the velocity of circulation may represent a movement of deposits from idle time to active sight deposits or an increase in the rate of turnover of active time deposits.

The Supply of Money in relation to Other Economic Phenomena.
(1929 = 100.)

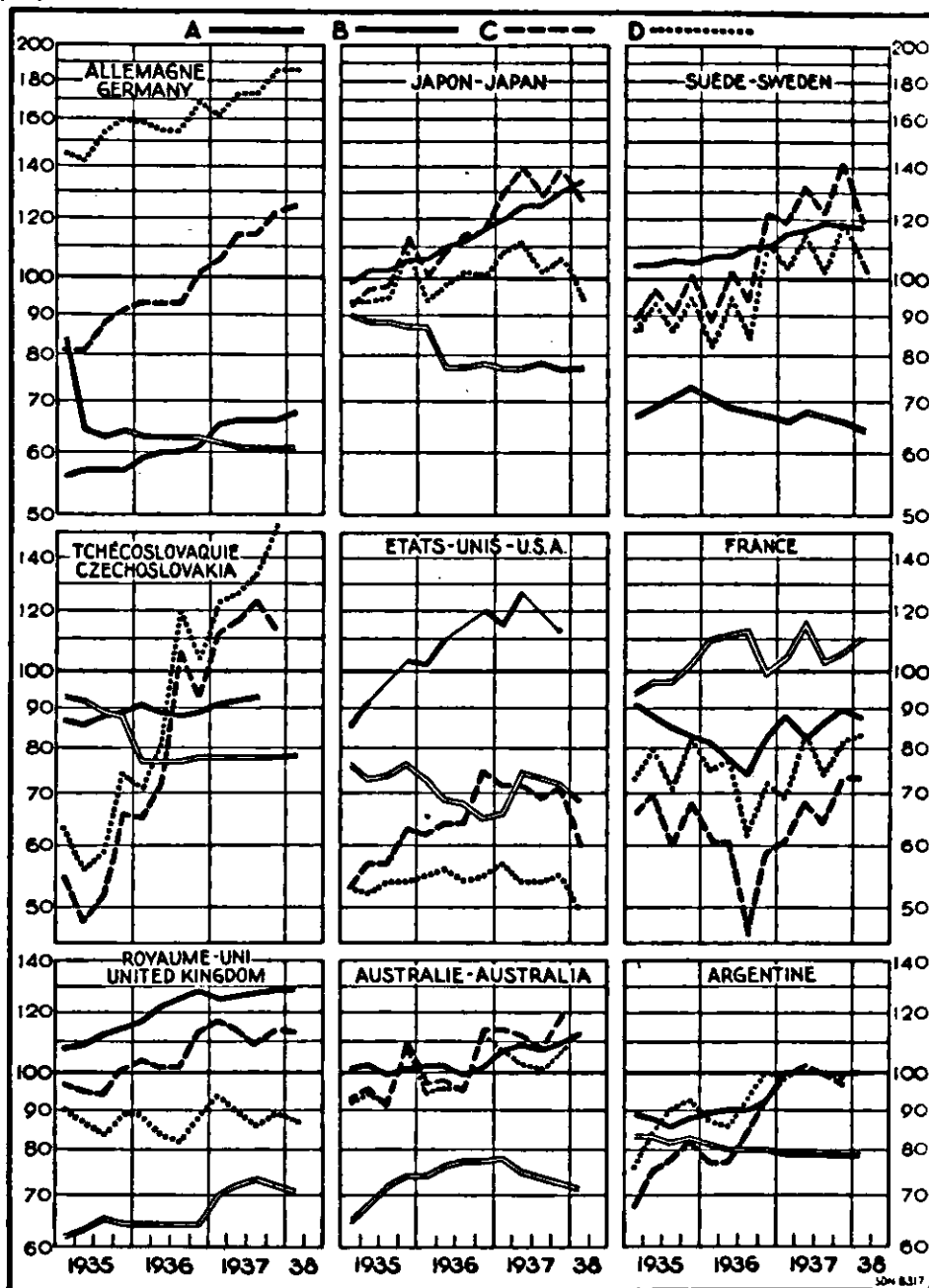
A Bond yields.¹

B Total deposits.

C Clearings.²

D Velocity of circulation.³

(Logarithmic scale.)



¹ *Australia*: Up to July 31st, 1931, 5% bonds, redeemable 1948; since October 1931, 4% bonds, redeemable 1950.

² *United States*: Outside New York City.

³ *United States*: This index, adjusted for seasonal variations, is computed by the Federal Reserve Bank of New York and refers to the velocity of circulation of demand deposits outside New York. No comparable index is available for total deposits.

France, the volume of bank clearings, representing the volume of transactions financed with deposit money, has increased considerably with the recovery in business since 1934; and in every case except France, the United States and the Argentine, the volume of clearings had risen by 1937 considerably above the 1929 level. In the United Kingdom, the velocity of circulation of deposits remains lower than in 1929; but there has been a considerable increase in the supply of deposit money, and this has been accompanied by low interest rates. The low rates of interest obtainable on other assets may in part explain the tendency to hoard money which is revealed by the lower velocity of circulation. The German experience has been very different. For, in this country, the supply of deposit money remains much lower than in 1929; but, on the other hand, the velocity of circulation of deposits has risen rapidly to a very high level in 1937, in spite of low rates of interest. In this case, the tendency to dishoard money, represented by the high velocity of circulation, has itself been one of the main causes of the fall in interest rates. In France, interest rates in 1937 remained above the 1929 level and business activity remained at a low level, although some increase in the volume of transactions became apparent during 1937. But both the supply of deposits and their velocity of circulation remained depressed, and this caused a shortage of funds which was sufficient to explain the continuation of high interest rates. In the United States, the velocity of circulation of demand deposits has remained at a very low level; but the plentiful supply of money, taken in conjunction with the continuation of a relatively low volume of transactions to be financed, has been sufficient to maintain interest rates at a low level. In Japan and Sweden, increasing supplies of deposit money, combined with some rise in the velocity of circulation of deposits, have been accompanied by low interest rates. In Czechoslovakia, a slowly increasing supply of deposits and a rapid rise in their velocity of turnover have been combined with a marked fall in interest rates since 1934. In both Australia and the Argentine, clearings, deposits and their velocity were all remarkably close in 1937 to the 1929 level, but, as in other countries, interest rates were considerably below the 1929 level.

MONETARY POLICY AND GOVERNMENT FINANCE

During the period covered by this *Survey*, there has been a number of important developments in the monetary situation in the United States. As has already been explained in Chapter I,

a marked change took place between 1936 and 1937 in the need of the Federal Government to borrow in the market to cover its net excess of expenditure over revenue. In 1936, the budget deficit, including the payment of the veterans' bonus, had caused the Government to borrow on a large scale; in 1937, measures were taken to decrease the budgetary deficit, and, at the same time, the social security taxes were levied and were made available for investment in Government securities. The following figures ¹ show how the heavy Government demands on the capital and money markets fell during the first half of 1937 and by the middle of that year were replaced by a repayment of funds to the market.

*Call on the Market for New Money by the
United States Federal Government.*

\$ (000,000's).

Period	1936	1937	1938
First quarter	239	261	— 169 ^a
Second quarter	1,667	246	...
Third quarter	981	— 178 ^a	...
Fourth quarter	911	— 13 ^a	...

^a Net redemptions by the United States Federal Government.

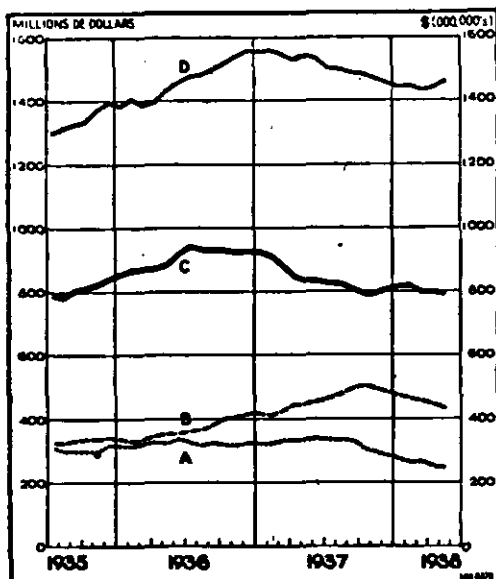
The effect of these changes on the level of business activity has been discussed at length in Chapter I; in this chapter, it remains only to discuss their effect on the money market. It might have been expected that a change on this scale from borrowing to lending on the part of the Government would have caused a considerable easing of the conditions on which money could be borrowed. But, in effect, long-term and short-term interest rates rose quite sharply in the early months of 1937, as can be seen from the graph on page 108; and, although long-term rates fell again later in the year, they remained on a higher level.

This paradoxical result is to be explained by the monetary policy which was adopted at the same time. As the following graph shows, the amount of Government securities held by the reporting member banks in the United States started to fall in the middle of 1936; and these sales of securities by the banks continued at a more rapid rate during 1937, and in parti-

¹ Cf. *Eighth Annual Report of the Bank for International Settlements*, page 90.

Reporting Member Banks.

- A Loan on securities.^a
- B Other loans.^b
- C U.S.A. Government obligations.
- D Demand deposits adjusted.^c



- ^a Mainly loans to finance transactions on the Stock Exchange.
- ^b Mainly loans to commercial customers.
- ^c Demand deposits available to the public.

ular during the early months of that year. As can be seen from the graph, this was due in part to a rise in the demand for other loans from the banks to finance business transactions, but mainly to a restrictive monetary policy which was accompanied by a fall in the deposit money supplied by the banks.

As a result of these sales of securities by the banks the total amount of Government securities which had to be absorbed by other purchasers increased considerably in spite of the diminution in the amounts borrowed by the Government. This fact, which is illustrated by the following figures, explains the rise in interest rates which occurred in the early part of 1937.

\$ (000,000's).

	1936		1937	
	June	December	June	December
Total "open-market" debt.	30,981	32,022	32,934	33,054
Held by member banks	11,721	11,639	10,870	10,578
Held by others	19,260	20,383	22,064	22,476

During 1936 and the first part of 1937 a number of restrictive monetary measures were taken to prevent too rapid inflationary and speculative tendencies. For not only was the supply of deposit money increasing rapidly during 1935 and 1936,¹

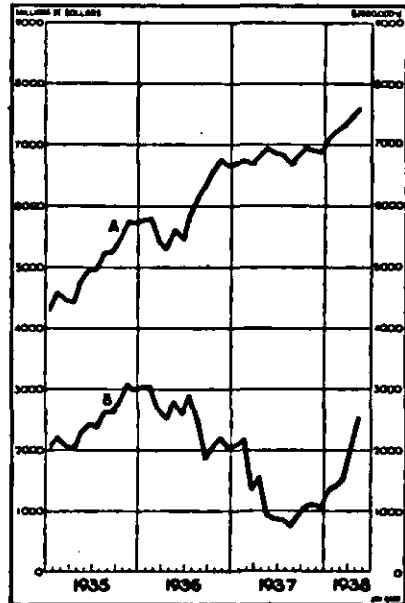
¹ Cf. the graph on this page.

but also the banks held exceptionally large reserves in excess of their legal requirements as a result of the large inflow of gold into the United States, and this provided the possibility of a further large expansion of deposits. In March 1936, in order to hinder Stock Exchange speculation, the proportion of the value of securities held on borrowed money which the purchasers themselves were required to cover with their own funds was raised to 55%. The main problem, however, was to reduce the excess reserves of the member banks; and, to deal with this, their legal reserve requirements were raised by 50% in August 1936, and by a further 50% during the first half of 1937. Moreover, in order to prevent the inflow of gold from causing a further increase in the member banks' reserves, a policy of gold sterilisation was adopted, by means of which imported gold, instead of swelling the banks' reserves, was bought for an "inactive gold fund" by the Treasury. The effect of these measures in reducing the excess reserves of the member banks is shown in the following graph.

Although a comfortable volume of excess reserves still remained in 1937, this policy created difficulties for certain individual banks; and this, combined with the fact that bankers had become accustomed to much higher levels of excess reserves, led to the sale of Government securities and the reduction in the total supply of deposits, to which reference has been made above. As a consequence of the "gold scare"¹ in the first half of 1937, there was an accelerated inflow of foreign balances into the United States, and these sums were placed on deposit rather than invested in Stock Exchange securities. For this reason, the supply of deposit money available for domestic purposes was reduced by a greater amount than the figures for deposits themselves would suggest.

Member Bank Reserves.

- A Total reserve balances.
- B Excess reserves.



¹ Cf. Chapter VII.

As a consequence of the business recession, there has been a marked change from a restrictive to an expansionist monetary policy since the middle of 1937. The Federal Reserve banks reduced their discount rates from 2% to 1½% in August and September 1937;¹ and, in October, the rules regulating the type of paper which might be used for rediscount with the reserve banks were relaxed. In November, the margin requirements were reduced from 55% to 40% for loans made for the purpose of purchasing Stock Exchange securities. In the same month, the reserve banks purchased \$38 million of Government securities in the open market. But the most important measure taken in the autumn of 1937 to increase the liquidity of the banks was the release of \$300 million of gold from the inactive gold fund by the Treasury in September. The Treasury sold \$300 million of gold certificates, representing the released gold, to the reserve banks, and used the proceeds to repay an equivalent amount of maturing obligations; and as the former holders of these securities paid the proceeds into their accounts with the banks, the cash reserves of the banks were increased by an equivalent amount. As the business recession continued, this policy of desterilising gold was pursued further. In February 1938, it was decided that the first \$100 million of gold received by the United States in each quarter of the year would be allowed to exert its full influence in increasing the reserves of the banks, and that only amounts in excess of that figure would be sterilised. In April 1938, the inactive gold fund was abolished; and gold certificates representing \$1,400 million of gold were sold by the Treasury to the reserve banks. It has been announced that the Treasury balances obtained from the sale of these gold certificates will be used to redeem \$50 million of Treasury bills each week, and this is calculated to increase the cash reserves of the banks by an equivalent amount.

This last decision was part of a comprehensive policy to combat the business recession by monetary expansion and by increased Government expenditure. The legal reserves which the member banks are required to keep against their deposits were reduced in April 1938;² and this immediately

¹ Except the Cleveland Reserve Bank, which had reduced its rate to 1½% in May, and the Reserve Bank of New York, where the reduction in August was from 1½% to 1%.

² The reductions in reserve requirements were as follows:

Demand deposits:	From	To
Central reserve city banks	26%	22¼%
Reserve city banks	20%	17½%
Country banks	14%	12%
Time deposits:		
All member banks	6%	5%

transferred \$750 million of reserves from the "required" to the "excess" category in addition to the prospect of the increase in reserves of \$1,400 million, which will ultimately be caused by the abolition of the inactive gold fund. The effect of this policy of monetary expansion on the reserves of the banks and on the supply of deposit money can be seen from the graphs on pages 102 and 103; and, as the graph on page 108 shows, the immediate effect of the increased supply of bank reserves was to cause a considerable reduction in interest rates. At the same time that these monetary measures were taken, the President proposed to Congress a programme of Government expenditure on relief and public works amounting to over \$3,000 million for the fiscal year 1938/39; and in addition to this, the Reconstruction Finance Corporation was authorised to lend an additional \$1,500 million to private industry. These measures of Government expenditure to increase business activity are discussed in greater detail in Chapter IX.

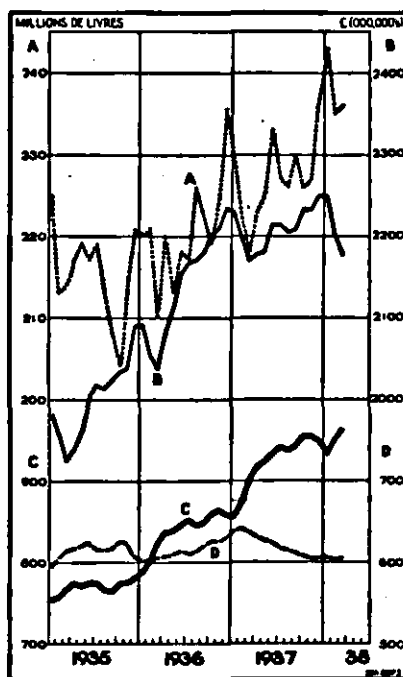
In June 1938, further measures were taken to ease the conditions on which the banks might extend credit. The maximum period for which member banks might grant loans to customers was extended from nine months to ten years; and the banks were authorised to invest in the bonds of local companies, even if they were not quoted on any Stock Exchange.

In the United Kingdom, as can be seen from the graph on page 108, short-term rates of interest continued on a very low level throughout 1937 and the first months of 1938; but long-term rates rose appreciably in the early months of 1937 and have continued on a higher level. The graph opposite explains one of the reasons for this hardening of interest rates.

During 1937, the expansion in the total supply of deposit money was checked; for the cash reserve ratio of the banks had fallen to the conventional minimum

Ten Clearing Banks

- A Cash.
- B Deposits.
- C Advances.
- D Investments.



of 10% by the end of 1936.¹ But, during 1937, the continued recovery of business activity led to an increase in bank advances to industry, and, to finance this, the banks were obliged to reduce their investments in Government securities.

A further reason for the rise in the yield on Government securities was the announcement by the Government in February 1937 of its intention to spend £1,500 million on rearmament during the next five years and to finance £400 million of this by borrowing;² and this announcement caused some readjustment of security values in the expectation of higher interest rates when the new borrowing took place. In actual fact, however, the rearmament programme up to the present has caused little additional borrowing, as the net budget deficit for the year 1937/38 was no greater than £25.5 million.³ The first National Defence Loan of £100 million was issued in April 1937 in advance of the requirements for expenditure on arms; and this loan is believed to have been mainly taken up in the first instance by public departments, such as the Post Office and trustee savings banks, and the National Health and Unemployment Insurance Funds, whose annual savings are estimated to be from £75 to £80 million per annum.⁴ The proceeds of the loan were used in the first instance to consolidate the short-term debt. Similarly in June 1938, a second National Defence Loan of £80 million was issued in advance of requirements.

The very low rates of interest on commercial and Treasury bills are to be explained by the scarcity of such bills in relation to the demand for them by the commercial banks to form part of their liquid assets. Commercial bills have fallen greatly since 1929 as a result of the decline in the value of international trade and of changes in the methods of financing such trade; and there is also evidence of an increased demand for bills on the part of other investors. At the same time, the supply of Treasury bills to the market has not increased much since 1929 in spite of the fact that the Exchange Equalisation Fund has normally financed its large purchases of gold since 1932 by the sale of Treasury bills to the market.⁵ The explanation of this lies in the funding and other long-term loans which the Government has issued since 1932 to reduce the floating debt. Indeed,

¹ This is easily seen in the graph, where the vertical scale for deposits is one-tenth of that for cash, so that, whenever curve A touches curve B, the cash reserve ratio has dropped to 10%.

² Cf. Chapter I.

³ Cf. Chapter I, page 32.

⁴ *The Economist*, November 6th, 1937, page 259.

⁵ For estimates of the quantitative importance of these different factors, see League of Nations: *Money and Banking, 1937/38*. Volume I, pages 49 ff.

this method of financing the purchase of gold by the Exchange Equalisation Fund — indirectly through the issue of long-term bonds instead of through the issue of additional Treasury bills — probably had the paradoxical effect of making the inflow of foreign money during 1937 responsible for a reduction in the supply of liquid funds and so for a hardening of interest rates. It has been estimated ¹ that, during the first nine months of 1937, the Exchange Equalisation Fund purchased some £190 million of gold, and that the supply of Treasury bills on the market actually fell during the same period; for the gold purchases were financed partly from a revenue surplus, partly from the proceeds of the National Defence Loan and partly from other sources, such as the purchase of Treasury bills by various Government Departments either out of current accruals to their funds or by the sale of long-term securities on the market. But as the imported “hot” money was probably invested in liquid funds such as deposits or Treasury bills, and as the supply of deposits and Treasury bills was not increased, the net result was the withdrawal of liquid funds from the market and the maintenance of interest rates at a higher level. During May 1938, there was a large movement of short-term funds from London to Paris; and the immediate result of this movement was to reduce the cash reserves of the London banks, since funds were paid to the Exchange Equalisation Fund in the purchase of gold for shipment to Paris. As the authorities invested these funds in Government securities or made use of them to finance an excess of Government expenditure over Government receipts, the cash reserves of the London banks were restored; and, in this case, the dehoarding of liquid sterling balances to finance the repatriation of funds to France may ultimately increase the supply of active funds in the London market.

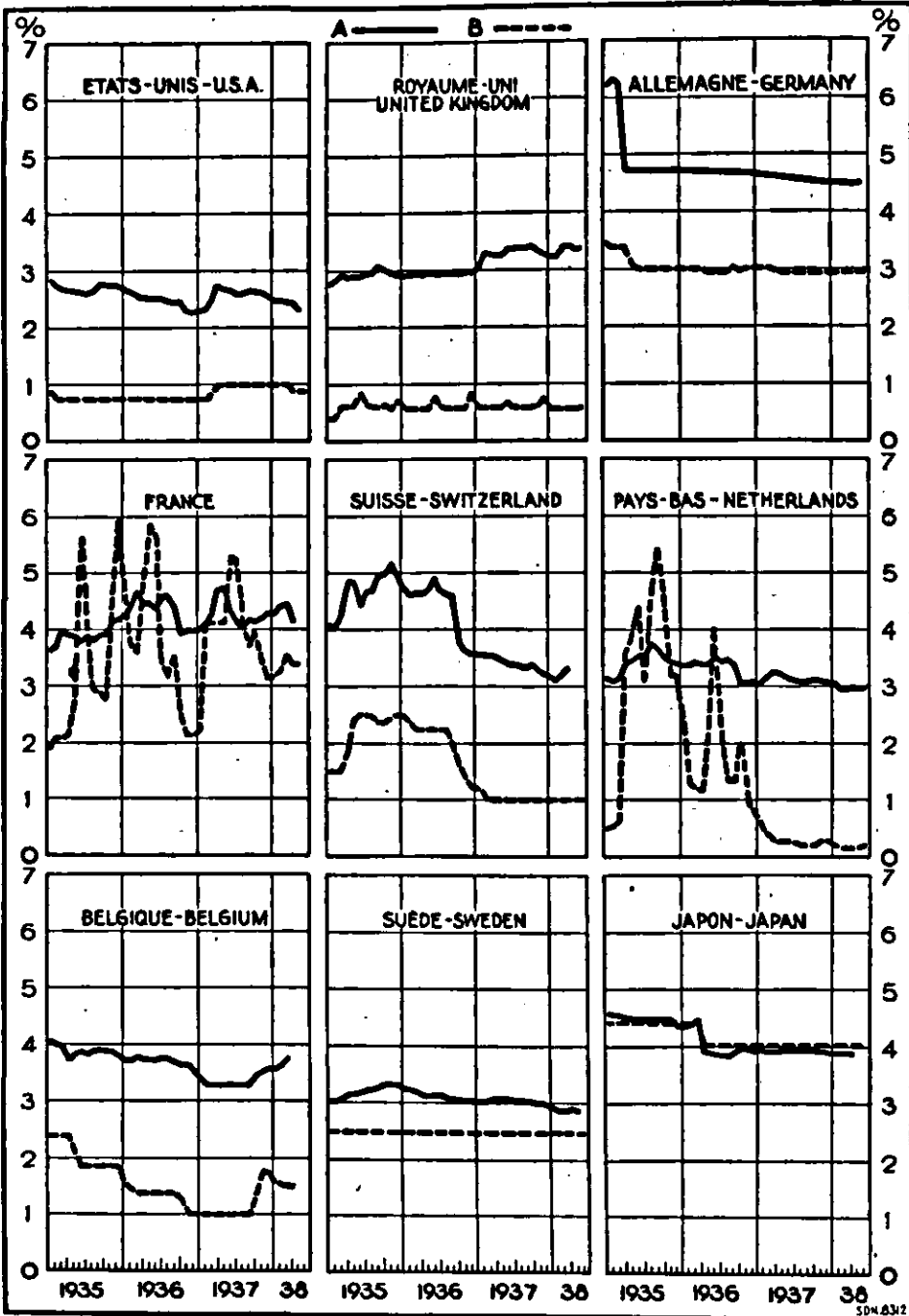
In recent months, it appears, every effort has been made to continue the policy of cheap money. At the end of 1937, the Fiduciary Issue of the Bank of England was raised temporarily from £200 to £220 million to meet the seasonal increase in the demand for cash; and, as can be seen from the graph on page 105, the cash reserves of the London banks stood at a high figure at the beginning of 1938, so that there was no obstacle in the way of continuing easy credit conditions.

In France, as can be seen from the graph on page 108, interest rates have moved in a very different way from the other countries of the old gold bloc which devaluated their currencies

¹ Speech of Mr. J. M. KEYNES to the National Mutual Life Assurance Society, reported in *The Times*, February 24th, 1938.

Long-term and Short-term Interest Rates.

- A Percentage yield of Government bonds.¹
- B Market rates of discount.



¹ Germany: On April 1st, 1935, the 6% bonds were converted into 4½%.

in October 1936. Both in the Netherlands and in Switzerland, interest rates fell sharply after the devaluation. In these countries, not only did the devaluation remove the necessity of maintaining a restrictive monetary policy to prevent further losses of gold reserves; but the return of short-term capital increased the supply of funds to such an extent that easy monetary conditions were inevitable.¹ In France, on the other hand, the devaluation of the franc in October 1936, after leading to some immediate fall in short-term interest rates, was followed by further internal economic difficulties and by a further flight of capital and foreign exchange difficulties.² In consequence, short-term interest rates rose again until the middle of 1937, when the pressure on the franc was temporarily removed by a second devaluation. In spite of this, however, short-term and long-term interest rates at the beginning of 1938 were considerably higher than they had been at the end of 1936. High interest rates continued in spite of the fact that Government finance throughout 1937 and the early months of 1938 tended to increase the supply of liquid funds. As has already been explained in Chapter I, the advances of the Bank of France to the Treasury increased by some 14,000 million francs — from 17,700 to 31,900 millions in the course of 1937 — and this should have increased the supply of central-bank money to an equivalent amount. In addition to this, in July 1937, a fund for the support of French Government securities was instituted, and was credited with the book-keeping profit of nearly 7,000 million francs resulting from a second revaluation of the Bank of France's gold reserves; and the expenditure of this sum on the purchase of Government securities should have had the same effect in increasing the supply of funds in the market. In June 1938, the Bank of France was empowered to undertake "open-market" operations in short-term Government bonds and trade bills; and this should enable the bank to assist the Government in developing a cheap money policy through the purchase of such securities.³

The fact that interest rates failed to fall appreciably in spite of these reflationary operations may be ascribed to two major factors. In the first place, France continued to lose gold as a result of the continued flight of capital⁴ and of the

¹ Total commercial-bank deposits increased from 3,150 to 3,277 million francs in Switzerland, and from 964 to 1,126 million guilders in the Netherlands, between December 1936 and December 1937.

² The internal economic difficulties have been discussed in Chapter I. The foreign exchange problems will be examined in Chapter VII.

³ In Hungary and Switzerland also, the central banks have recently been empowered to undertake "open-market" operations.

⁴ Cf. Chapter VII.

increasingly adverse balance of trade.¹ Between January 1937 and April 1938, the gold and foreign exchange reserves of the Bank of France fell by 2,200 million francs — from 58,800 to 56,600 millions — in spite of the revaluation of the gold stock in July 1937; and this loss of gold withdrew funds from the market. At the same time, as has already been shown in Chapter I, prices and costs rose very considerably throughout 1937, so that there was a considerable increase in the demand for funds to finance the same level of production at higher prices. In consequence, in spite of increases in the note circulation from 87,700 million francs to 92,300 millions and in the total deposit liabilities of the four leading commercial banks from 29,300 million francs to 30,000 millions between January 1937 and January 1938, there was no appreciable easing of credit conditions.

In May 1938, as a consequence of a further depreciation of the franc and of measures taken to set a final limit of 179 francs to the pound, below which the franc exchange would not be permitted to fall,² funds were repatriated to France on a large scale.³ This repatriation of funds had an immediate effect on internal monetary conditions, although it is still too early to judge the permanence of these results. The Bank of France's discount rate was reduced from 3% to 2½%. The demand for Treasury bonds increased; and after two reductions in the rate of interest on these bonds — from 4% to 3½% and 3¼% — subscriptions for them were suspended. The price of Government securities rose sharply. A new National Defence Loan of 5,000 million francs — issued on terms advantageous to investors⁴ — was quickly subscribed in full.

As can be seen from the graph on page 108, both long-term and short-term interest rates have risen in Belgium since the last quarter of 1937. The repatriation of foreign funds has caused a loss of gold; and, in May 1938, some further speculative movement of funds from Belgium took place, both as a result of the devaluation of the French franc to a lower limit of 179 francs to the pound and as a consequence of the recession of business activity which reacted adversely on Belgium and caused some uncertainty as to the maintenance of the fixed gold value of the Belgian currency.⁵ In consequence, the official rate of discount was raised from 2% to 4% in the middle of May 1938, but was subsequently lowered again to 3%.

¹ Cf. Chapter VI.

² Cf. Chapter VII.

³ It has been estimated that 18,000 million francs were repatriated in the first week after the devaluation. Cf. *The Economist*, May 14th, page 363.

⁴ The loan bore interest at 5%, and, in addition, was offered at a price of 98, to be redeemed between 1941 and 1968 at 120.

⁵ Cf. Chapter VII for a discussion of the foreign exchange position in Belgium.

In both Germany and Japan, in spite of the continuation of economic activity at high levels, there has been no hardening of interest rates. The measures taken to finance rearmament and the four-year plan in Germany, and the war expenditure in Japan, have already been described in Chapter I. The continued investment in additional bills by the Reichsbank and the other German banks in spite of the issue of large consolidation loans has provided a plentiful supply of funds to finance the Government's expenditure; but, in March 1938, it was announced that the issue of special bills would be discontinued, and that, in future, all State expenditure not covered by current tax revenue would be financed by loans issued at regular intervals in the open market. In Japan, the greater part of the issue of Government bonds, to which reference has been made in Chapter I, has been taken up by the banks, as the following figures show:

Government Bonds.

- Yen (000,000's).

	End of 1936	1937	Net increase
Holdings of banks	6,999	8,032	+ 1,033
Holdings outside banks	2,073	2,553 *	+ 480
Total	9,072	10,585	+ 1,513

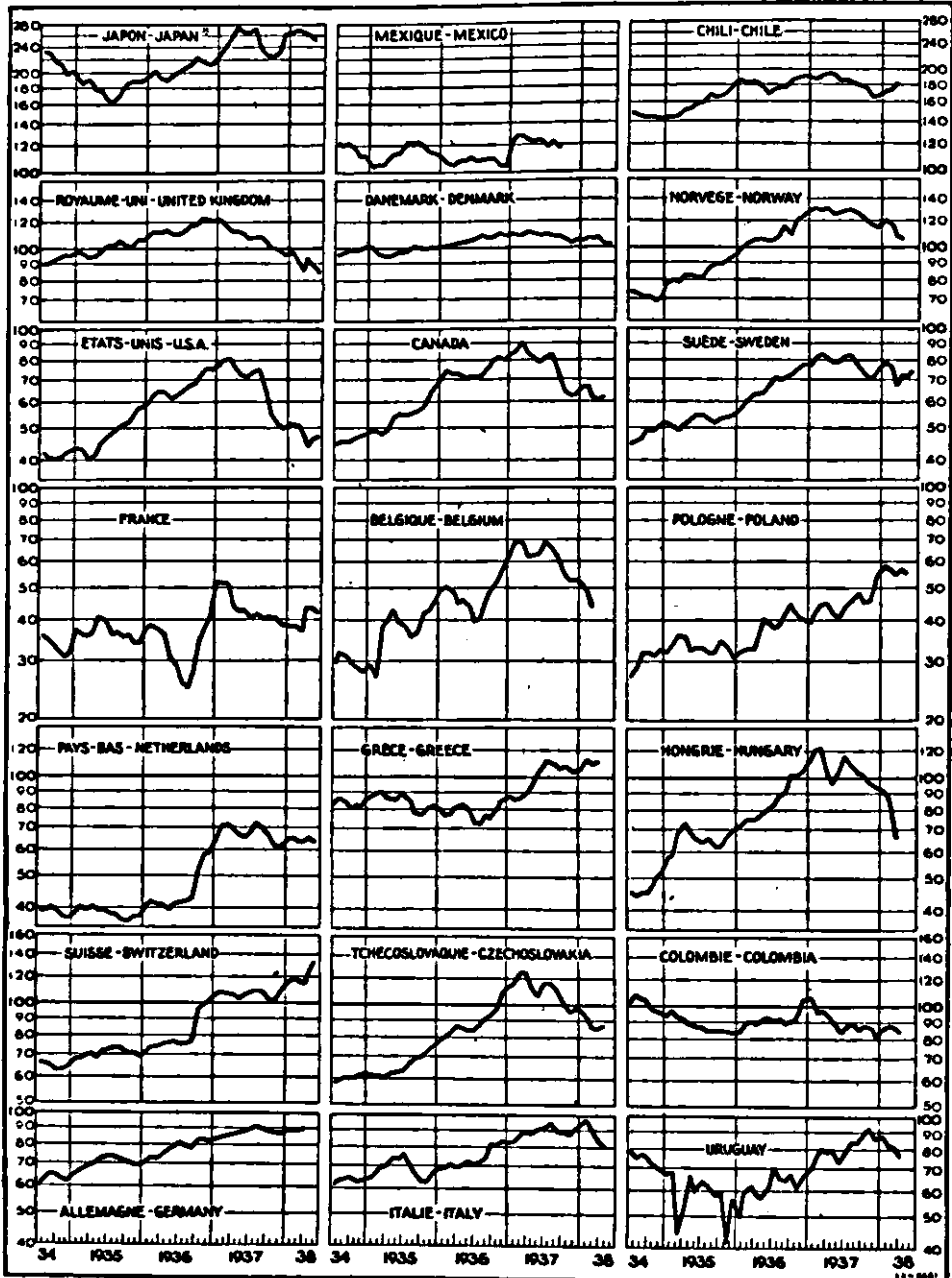
* This figure probably includes the 200 million yen of Government bonds purchased from the Bank of Japan by the Gold Fund Special Account, which was set up out of the profits from the revaluation of the gold reserve in August 1937. For this reason, out of the total increase in Government bond holdings of 1,513 million yen, only 280 millions properly represent an increase in holdings outside the banks.

In consequence, the total deposit liabilities of the ordinary commercial banks increased from 10,932 to 12,353 million yen in the course of 1937. In addition, certain special measures have been taken to ease Government borrowing. In July 1937, the Bank of Japan reduced its rate on loans granted on the security of Government bonds from 3.65% to 3.29%; and, in August 1937, the Bank was authorised to purchase Government bonds in the open market besides continuing to take up new bonds direct from the Government in order to resell them to other banks. In August 1937, the gold reserves of the Bank of Japan were revalued and the resulting profit accrued to the

Movement of the Market Value of Industrial Shares.

(1929 = 100.)

(Logarithmic scale.)



* Japan: Base 1930 = 100.

Government, which arranged to use 200 million yen of this profit to purchase Government bonds from the Bank of Japan and 450 million yen to take up Industrial Bank debentures. By these means, the supply of money has been kept plentiful and interest rates have been prevented from rising in spite of the demands made necessary by war activity.

THE SECURITY MARKET

During 1936, industrial share prices rose considerably in nearly all countries; for, as economic recovery progressed, not only did profits rise, but the expectation of future profits also improved. As can be seen from the graph on page 112, this recovery in share prices was most marked at the end of 1936 in France, Switzerland and the Netherlands, when these gold bloc countries devaluated their currencies and so removed the monetary obstacles standing in the way of economic expansion. But, as the graph shows, this trend showed a marked change in the course of 1937. Although share prices continued to rise in Germany, Italy, Japan and a few other countries, they fell in the great majority of countries in the course of the year. This change of trend must be ascribed mainly to the decline in business activity which occurred in the course of the year. But while business activity did not decline significantly until the last half or the last quarter of the year, the fall in share prices occurred in many cases at an earlier date. In the United Kingdom, share prices reached their peak as early as the end of 1936; and in the United States, France, Mexico, Denmark, Canada, Belgium, Czechoslovakia, Chile, Norway, Sweden and Hungary, the peak was reached in the early months of 1937.

As has already been shown, the yield on Government bonds rose in certain countries, notably the United Kingdom and the United States, in the first quarter of 1937; and some part of the decline in share prices may be explained as a readjustment of share values to correspond to the higher yields obtainable on bonds. But this is not sufficient to explain either the extent of the fall in share prices or the early period at which share prices started to fall in the United Kingdom. The most important factor determining share prices is the expectation of the future profits which will be earned on these shares. It appears that profit expectations in the United Kingdom deteriorated at the end of 1936, possibly as a result of uncertainty as to the future course of consumers' demand, of a

feeling of international insecurity, and of the expectation of burdensome taxes for rearmament, which outweighed the stimulating effect which might be expected from rearmament expenditure. This fall was accentuated by the rise in interest rates and the new rearmament tax on profits in the first quarter of 1937, and, at a later date, by the American Stock Exchange slump and the business recession. In the United States, a sudden increase in dividend payments had been caused in the middle of 1937 by the tax on undistributed profits;¹ and this may have led to over-optimistic expectations, the non-fulfilment of which may have caused an exaggerated reaction. At the same time, the reduction in new orders and the rise in raw material and wage-costs early in 1937 probably reduced the anticipation of profits in a number of important industries. This change in profit expectations was partly responsible, not only for the decline in share prices, but also for the decline in business activity itself; and, as soon as the business recession started, the fall in share prices was sharply accentuated.

The table on page 115 enables a comparison to be made between the movements of industrial share prices and of profits in a number of countries. In making this comparison, it must be remembered that, while industrial share prices are dependent mainly on the expectation of future profits, the profit figures themselves show the result of business operations in the immediate past. In many countries, the profits shown for each year have been earned largely in the previous year. In a number of countries, such as the United States, the United Kingdom, Germany and Japan, it will be seen that the indices of profits were considerably lower than the indices of share prices in 1933; and this is to be explained by the fact that, at that time, profits were expected to recover from the low levels which they had then reached. In the countries of the old gold bloc, however, the bottom of the depression was not reached until some years later. In France, in 1933, the index of share prices was lower than that of profits, which suggests that some further considerable fall in profits was expected. In all the countries except those of the old gold bloc, a considerable recovery of profits and of industrial share prices took place between 1933 and 1936; and it will be seen from the table that this recovery continued into 1937. In every country shown in the table, except the United Kingdom, share prices were higher in 1937 than in 1936, although, as has been seen, this upward trend of share prices changed in the course of 1937. In every country

¹ Cf. Chapter 1.

Profits, Share Prices and Capital Issues.
(1929 = 100.)

	1933	1936	1937
<i>France:</i>			
Estimated profits earned by tax-payers	62.3	53.8 ^a	...
Industrial share prices	44.8	33.4	43.8
Total capital issues by domestic companies	51.0	18.7	27.2
<i>Germany:</i>			
Profits (extractive and manufacturing joint-stock companies)	(Net loss)	49.9 ^a	...
Industrial share prices	51.7	77.8	87.3
Total share issues	9.3	40.3	34.0
<i>Japan:</i>			
Profits (industrial, commercial and financial companies)	94.2	157.1	...
Industrial share prices ¹	176.7	205.8	251.7
Total share issues	110.1	179.3	...
<i>Netherlands:</i>			
Dividends (all joint-stock companies)	48.4	49.6 ^a	79.6 ^a
Industrial share prices	38.0	45.1	67.0
Net capital issues by domestic companies	3.1	3.4	22.2
<i>Sweden:</i>			
Profits (twenty-five industrial companies)	45.4	89.8	109.2
Industrial share prices	36.9	67.3	78.8
Total share issues	35.2	53.0	64.6
<i>Switzerland:</i>			
Dividends (industrial joint-stock companies)	59.0	47.2	...
Industrial share prices	63.6	81.0	105.6
Net capital issues by domestic companies	15.8	7.3	19.3
<i>United Kingdom:</i>			
Profits (industrial companies)	63.4	96.5	113.2
Industrial share prices	74.1	115.7	108.3
Net capital issues by domestic companies	52.1	122.9	84.5
<i>United States:</i>			
Profits (120 industrial companies)	15.7	69.3	77.1 ^a
Industrial share prices	35.0	67.3	69.0
Net capital issues by domestic companies	0.2	14.8	14.8

^a Provisional.

¹ Base 1930 = 100.

^a 1935.

shown in the table, for which the figures were available,¹ profits were higher in 1937 than in 1936.

In the United States, this upward trend of industrial profits was reversed in the course of 1937. The index of industrial profits (1929 = 100), which stood at 77.1 for the complete year 1937, had fallen from 75.0 to 28.9 between the first quarter of 1937 and the first quarter of 1938. In the United Kingdom, on the other hand, the index of industrial profits, which averaged 113.2 for the complete year 1937, rose from 106.7 to 116.7 between the first quarter of 1937 and the first quarter of 1938; and although this last figure relates largely to profits earned in the course of 1937, the figures do not suggest that anticipations of lower profits have as yet been justified.² In Japan, the figures of the rate of profit earned by 190 companies (12.9% in the second half of 1936, 14% in the first half of 1937 and 13.8% in the second half of 1937) suggest that profits have moved downwards in the second half of 1937 after rising for many years. Heavy industries were very active; but industries producing consumption goods suffered from higher costs due to shortages of labour and raw materials, and the burden of taxation was heavier. For other countries, figures of recent changes in industrial profits do not appear to be available.

It is of interest to compare the changes in industrial profits and in industrial share prices with the movements of new issues of shares and bonds by companies for the finance of capital extensions. From the figures given in the table on page 115 it is evident that new capital issues remain in many countries far below the 1929 level. In a number of countries, the finance of capital extensions from funds accumulated by companies out of their profits has grown at the expense of new capital issues.³ In the United States, new capital issues by domestic companies in 1937 were only 14.8% of the 1929 level; in spite of the considerable measure of recovery in other aspects of economic activity. This recovery had, however, been largely dependent upon consumers' expenditure and upon Government, as opposed to private, expenditure on capital development; and, in view of the greater measure of official regulation of the conditions for new issues, companies have probably

¹ There is evidence that industrial profits in 1937 rose also in Germany and Japan. The net profits of certain German companies, published in the year October to September, rose from RM. 637 million in 1935/36 to RM. 890 million in 1936/37. The rate of return on the paid up capital of certain Japanese companies rose from 12.7% in the months March to August 1936 to 14% in the same period in 1937.

² Profits reported for the second quarter of 1938 were 12.8% higher than in the corresponding quarter of 1937. Cf. *Economist*, July 16th, 1938, page 108.

³ In the United Kingdom, for example, 28.2% of companies' net profits were put to reserve in 1937, as compared with 19% in 1929.

relied as far as possible on their own resources for capital expenditure. Since the decline in business activity in the autumn of 1937, activity on the new-issue market has fallen still further, and, between the first quarter of 1937 and the first quarter of 1938, the index of new issues by domestic companies (1929=100) has fallen from 19.3 to 5.5. In the United Kingdom, new issues by domestic companies had recovered to comparatively high levels in 1936 and 1937; but the same downward trend is evident for recent months, and the index of new issues by domestic companies fell from 150 to 45.1 between the first quarter of 1937 and the first quarter of 1938. After making every allowance for chance variations in these figures, the downward trend in the United States and the United Kingdom is clearly marked. In Germany, the issue of new shares remains at a low level in spite of the high level of economic activity. As has been explained in Chapter I, investment activity has recently been predominantly dependent upon Government and public activity; and companies have financed their extensions mainly from their own resources rather than from funds raised on the capital market, which has been dominated by the needs of Government finance. In Japan also, the new capital market was dominated by the needs of Government finance in 1937; and, as has already been explained in Chapter I, capital extensions by private businesses have been rigidly controlled and restricted. In France, the Netherlands and Switzerland, new issues have, since the currency devaluations of October 1936, increased somewhat from the very low levels to which they had been reduced by deflationary forces.

Chapter VI

INTERNATIONAL TRADE

THE CHANGING TREND OF TRADE

In previous chapters the changing trend of economic activity from recovery and prosperity to renewed depression has been observed in a number of branches of economic life.

During the period covered by this *Survey*, the trend of international trade has been reversed in three important ways. The quantum of world trade has ceased to grow and has suffered a serious decline ; the relation between the prices obtained for exports and the prices paid for imports, after moving to the advantage of countries producing raw materials and foodstuffs, has again become much less favourable to them; and at the same time the balances of trade of these countries, which improved substantially between 1934 and 1937, have recently suffered a serious reduction.

By 1937, the quantum¹ of world trade had recovered practically to the 1929 level; but this recovery had not been uniform for all types of commodity. As the following table shows, the quantum of trade in foodstuffs, which had fallen relatively little during the depression, was in 1937 7% below the 1929 level, while the quantum of trade in manufactured goods, which had fallen most heavily during the depression, remained as much as 14% below the 1929 level. On the other hand, the quantum of trade in raw materials, as a result of industrial recovery, the demand for rearmament purposes and speculative purchases of raw materials in the early months of 1937, was as much as 11.5% above the 1929 level.

More recent movements of world trade are illustrated in the first graph on page 120. The quantum of world trade rose rapidly during the second half of 1936 and the first half of 1937,

¹ Movements in the quantum of world trade are measured from changes in the value of trade after elimination of the effect of price changes.

*Quantum, Gold Price and Gold Value of World
Trade by Main Groups of Commodities.*

(1929 = 100.)

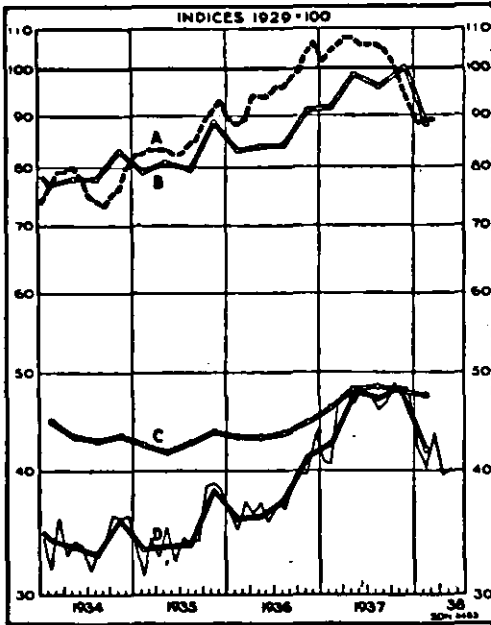
	1932	1936	1937
Quantum:			
Foodstuffs	89	88	93
Materials, raw or partly manufactured.	81.5	95.5	111.5
Manufactured articles	59	75	86
All articles	74.5	86	97
Gold Price:			
Foodstuffs	52	42	45.5
Materials, raw or partly manufactured.	44	41.5	46
Manufactured articles	64	48	51.5
All articles	52.5	43.5	47.5
Gold Value:			
Foodstuffs	46.5	37	42.5
Materials, raw or partly manufactured.	36	39.5	50
Manufactured articles	37.5	36	44.5
All articles	39	37.5	46

and by the fourth quarter of 1937 had reached the 1929 level. But its rise in the last quarter of 1937 was less than normally occurs at that season of the year; and only a small part of its fall in the first quarter of 1938 can be explained by seasonal influences. The gold prices of traded goods also reached their peak in the middle of 1937, and have since fallen; and in consequence of this moderate fall in prices and of the substantial reduction in the quantum of trade, the total value of world trade has suffered a serious decline.

The graph also enables a comparison to be made between movements in world trade and in the volume of industrial production. Largely as a result of the relative stability of the consumption of, and world trade in, foodstuffs, the quantum of world trade fluctuates less rapidly than the volume of industrial production. By 1932, the volume of industrial production had fallen much more than the quantum of world trade; but from 1932 the volume of industrial production recovered more rapidly than the quantum of world trade, until in the middle of 1937 it stood well above the 1929 level. Since the middle of 1937, the volume of industrial production has again fallen more steeply than the quantum of world trade.

World Trade and Industrial Production.
(1929 = 100.)

- A World Industrial production.
- B Quantum of world trade.
- C Gold price of world trade.
- D Gold value of world trade.



The graph at the foot of this page illustrates the dramatic change which has occurred recently in the price relationships in international trade. In a period of falling demand for goods and services, the prices of manufactured goods normally fall less than the prices of foodstuffs and of raw materials, while, on the other hand, the output of manufactured products normally falls more than the output of primary products. The difference in the behaviour of these two main types of commodity is mainly due to differences in their conditions of production. When demand falls off, industrial workers are dismissed, production is curtailed, and by this means prices are maintained. But, in the case of primary production, a reduction in demand

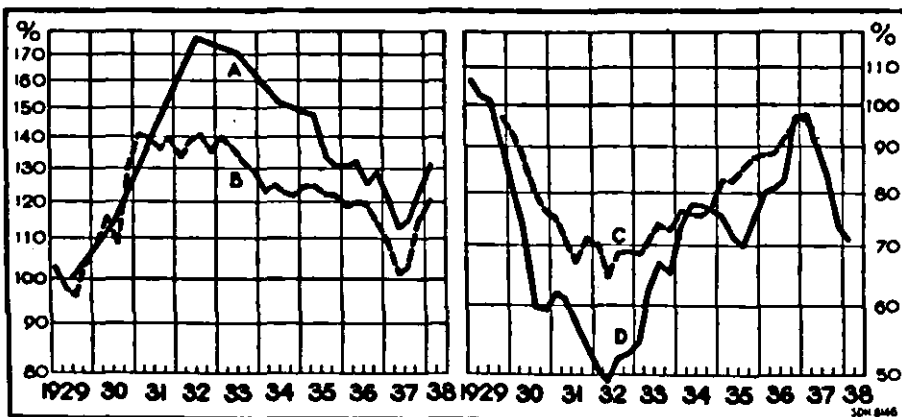
Export Prices as Percentage of Import Prices.
(1929 = 100.)

- A Germany.
- B United Kingdom.

(Prices of manufactured goods exported as percentage of those of raw materials imported.)

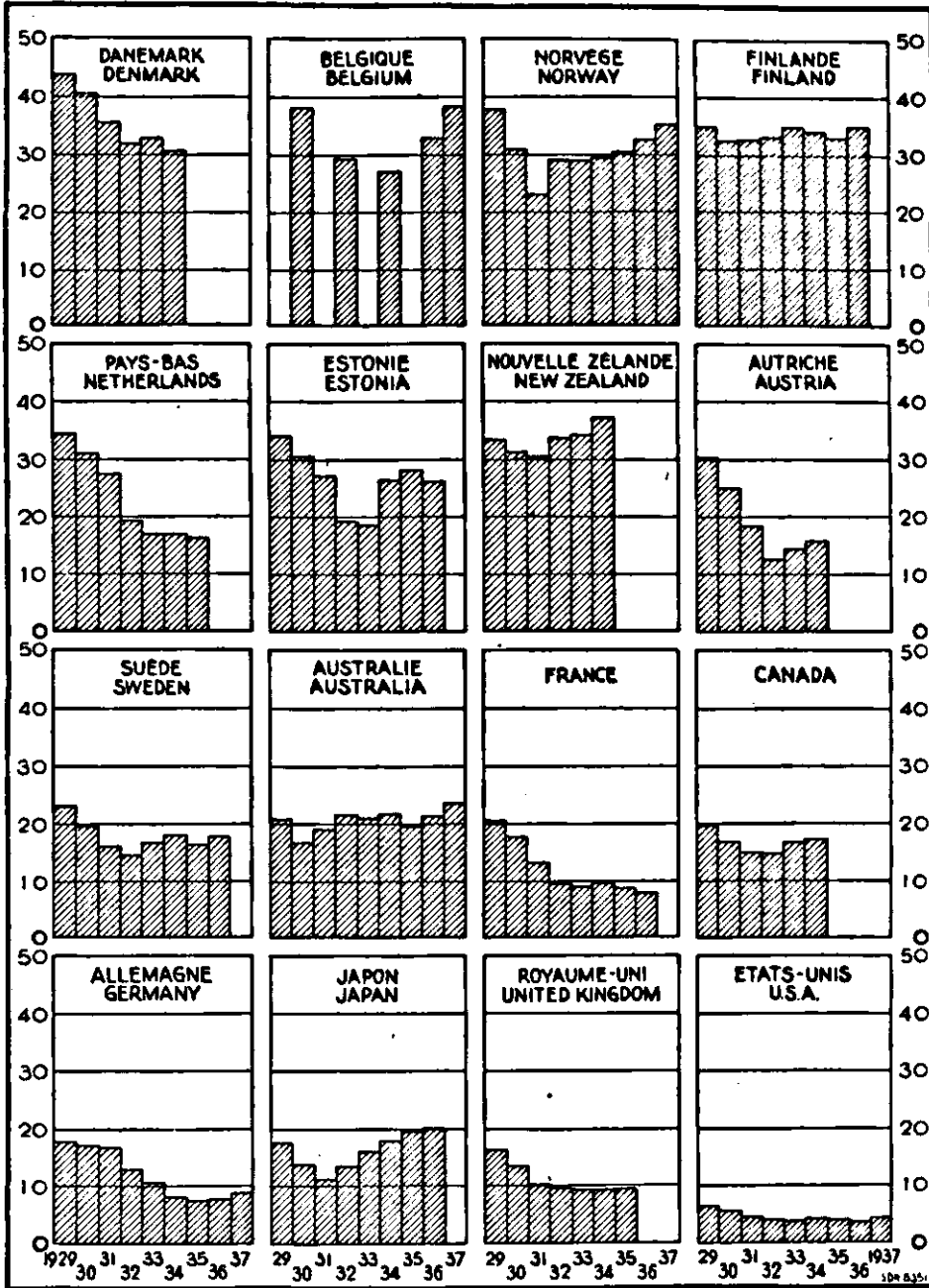
- C India.*
- D Netherlands Indies.

(Prices of all goods exported as percentage of those of all goods imported.)



* The curve for India from the second quarter of 1936 is based upon information available for March and December 1936 and March 1937 only.

Exports of Merchandise as Percentage of National Income.



leads only to a limited and slow reduction in production, and in consequence prices fall immediately and to a greater extent.¹

¹ In spite of the restriction schemes controlling the output of many primary products — to which reference is made in Chapter VIII — this greater instability in the prices of primary products has again been marked during the last two years.

As the graph shows, these price movements have had important effects upon the terms on which industrial countries—such as Germany and the United Kingdom—and countries producing primary products—such as India and the Netherlands Indies—can conduct their trade. From 1929 to 1932 the price of raw materials imported by the industrial countries fell much more rapidly than the prices of exported manufactures, and the terms of trade moved in favour of the industrialised countries. With the recovery in demand since 1932, the prices of primary products rose more rapidly than those of manufactured goods, and the terms of trade moved again in favour of the primary producing countries and against the industrial countries, until by the beginning of 1937 the price relationship had returned almost to the 1929 position. Since the collapse of prices of primary products in the early months of 1937¹ and the decline in business activity since the middle of 1937, there has been a dramatic change in this trend. The terms of trade have again moved sharply to the advantage of the industrial countries.

The recent change in the trend of international trade has been largely due to the reduction in the demand for imports on the part of the United States and other countries as a result of the decline in business activity. International trade is one of the most important channels through which a business recession in one country, by reducing the demand for imported products, affects adversely the level of activity in other countries. The extent to which any particular country is adversely affected by a widespread business depression in other countries is largely determined by its dependence upon export trade. For example, those countries which derive a large part of their income from the sale of goods in export markets would experience particular difficulties in attempting to prevent an internal depression by their own measures of internal expansion in face of a deepening depression in export markets. In order to illustrate the differences in the degrees of dependence upon exports, the graph on the preceding page shows the value of exports expressed as a percentage of national income for a number of countries for which the information is available.² Great disparities in the dependence upon foreign markets become clear at a glance; in 1929, exports ranged from 44% of national income in Denmark to 6% in the

¹ Cf. Chapter IV.

² The figures of national income on which the graph is based, and the sources from which these figures are taken, are given in a table at the end of this chapter. There are a number of differences in definition and in the method of measuring the national income; and for this reason no importance should be attached to minor differences in the ratio of exports to national income in the different countries. The changes in the ratio from year to year in any one country are probably of more significance than differences in the ratio as between different countries. The basic material from which the estimates are made is in many cases of a rough and approximate nature.

United States. As is to be expected, the small countries tend to be the most dependent upon foreign markets. In a number of countries there has been a considerable reduction in the proportion of exports to national income since 1929. This is apparent in Germany as a result of the control of foreign commercial relations and the drive towards self-sufficiency; in the United Kingdom as a result of greater reliance upon internal expansion than upon recovery of export markets since the abandonment of the free-trade policy in 1931; and in France and the Netherlands as a result of the rapid decline in export trade. This tendency for export trade to play a smaller part in the economic life of the country is noticeable also in the case of Denmark, Belgium, Norway, Estonia, Austria, Sweden, Canada and the United States. On the other hand, the rapid expansion of Japan's export trade since 1931 has made her more dependent upon exports than she was in 1929. Australia and Finland appear to be as dependent upon exports as in 1929, while in 1934 — the latest year for which information is available — New Zealand's dependence upon exports was greater than in 1929. Finally, the graph shows that in a large number of countries the proportion of exports to national income, after falling sharply during the first years of the depression after 1929, has shown some tendency to rise again in the subsequent years of recovery.

TRADE OF THE PRINCIPAL INDUSTRIALISED COUNTRIES¹

In the great majority of countries the gold value of world trade in 1937 was higher than in 1936. There were, however, some exceptions to this rule. Spain's trade declined as a result of the internal conflict. On the other hand, owing to a high level of trade during the first part of 1937, China's imports for 1937 were practically the same in value as in 1936, and her exports exceeded those of 1936 by 17% in spite of the Sino-Japanese war. The imports of the Union of Soviet Socialist Republics declined between 1936 and 1937 as a result of smaller purchases of machinery and iron products from Germany. Ireland's exports remained unchanged between 1936 and 1937 at a gold value considerably lower than the 1932 level, as a result of the policy of rapid industrialisation.

Apart from a relatively small number of instances of this kind, the value of each country's imports and exports rose between 1936 and 1937; but the most significant development

¹ Cf. League of Nations, *Review of World Trade, 1937*, page 23, and pages 32 *et seq.*

in international trade during the period covered by this *Survey* was not so much the relatively high level of trade reached in 1937, but the rapid change in the trend of trade. In no country was this change more dramatic than in the United States. During the first half of 1937, there was a rapid increase in the value of American imports and of American exports; but imports rose more rapidly than exports, and the United States experienced a considerable excess of imports over exports. During the second half of 1937, exports continued to expand, while imports declined rapidly, with the result that the United States achieved a very large excess of exports over imports. During the first months of 1938, both imports and exports fell, but the large excess of exports continued.

*United States: Excess of Imports (-) or of Exports (+)
of Merchandise.*

\$ (000,000's).

	1936	1937	1938
1st quarter	- 2.8	- 83.6	+ 324.2
2nd quarter	- 15.1	- 32.3	+ 304.1
3rd quarter	- 46.0	+ 85.0	...
4th quarter	+ 58.9	+ 313.9	...

The rapid fall in the value of American imports since the middle of 1937 is not simply due to the fall in the prices paid for imported raw materials. In fact, as the top graph on the following page shows, the quantum of American imports fell rapidly; and as the United States provide one of the most important markets for raw materials, this reduced demand for raw materials must be considered as one of the most important causes of the fall in the prices of primary products. The very close connection between the volume of industrial production and the quantum of American imports, which consist mainly of raw materials, is clearly shown in the graph. At the same time, however, the heavy imports in the first half of 1937 are in part to be explained by short crops in 1936, which necessitated exceptional imports of grain and fodder.

Part of the rapid increase in the quantum of American exports in the second half of 1937 is to be explained by the normal seasonal increase in exports. But there were a number of additional factors at work. The fall in the home demand for industrial products increased the supplies of such products available for export abroad at reduced prices, while business activity and buying power had not seriously declined in other

industrialised countries before the end of 1937. In the case of the primary producing countries, there is always a considerable time-lag between a change in their export markets and the consequent change in their expenditure on imports; and throughout the last half of 1937 such countries purchased industrial products freely from the United States as a result of their prosperous export trade during the first half of the year.

For these reasons American exports of industrial products remained high throughout 1937. Exports of a number of such products — for example, pulp, petrol, and cotton tissues— rose during the second half of the year. Annual figures show increases in export value between 1936 and 1937 of 71% for agricultural and 52% for industrial machinery, 83% for motor trucks and 30% for passenger motor-cars. The second graph on this page illustrates an important example of this increase in exports during 1937. Normally, iron and steel prices in the United States are too high in relation to such prices in the main consum-

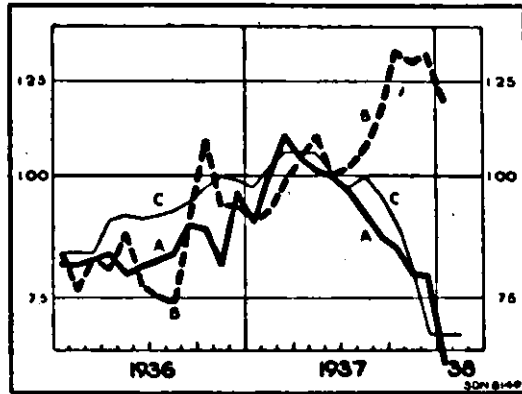
ing countries to allow any substantial exports. But in 1937 the heavy demand for such products by Japan and by certain European countries, combined later with the fall in demand and in market prices in the United States, enabled such products to be exported in large amounts on a competitive basis.

United States.

Quantum of Trade and of Industrial Production.

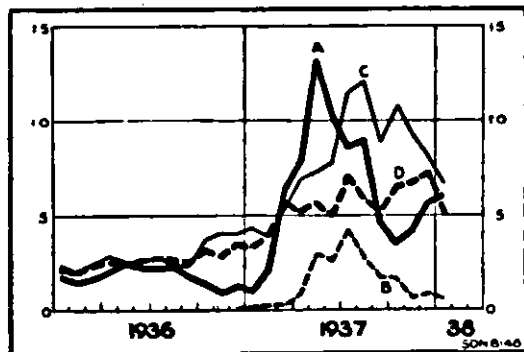
(June 1937=100.)

- A Quantum of imports.
- B Quantum of exports.
- C Volume of industrial production.



Exports of Certain Iron Products.
\$ (000,000's).

- A Scrap.
- B Pig-iron.
- C Bars, rods, plates (excluding tinplate), sheets.
- D Steel-mill manufactures.



In the United Kingdom, exports, which had risen substantially between the middle of 1936 and the middle of 1937, showed a falling trend during the last half of 1937 and the first months of 1938. But, on the other hand, imports continued to increase throughout 1937. As a result of these changes, which are illustrated in the graph on page 130, the United Kingdom experienced a very large excess of imports over exports; and this large excess of imports has continued during the first half of 1938, in spite of some fall in imports from the high levels attained at the end of 1937.

United Kingdom: Excess of Imports of Merchandise.

£ (000,000's).

	1936	1937	1938
1st quarter	78.3	90.3	108.9
2nd quarter	84.9	102.2	96.1
3rd quarter	81.1	109.9	....
4th quarter	106.9	135.4	....

The experience of the United Kingdom was therefore the reverse of that of the United States. In the United States, an internal depression led to decreased imports and to the sale of greater supplies of exports; and by these means a large excess of exports over imports was developed. In the United Kingdom, the demands of the rearmament programme and the maintenance — at any rate until the end of 1937 — of a high level of business activity increased the demand for imports and reduced the supplies of goods available for export; and this, combined with the recession in the United States in the second half of 1937, led not only to increased British imports, but also to reduced British exports. The increased imports into the United Kingdom took the form mainly of imports of manufactured goods, although raw-material imports also increased; and in 1937 the quantum of manufactured imports came to exceed the previous record level which had been reached in 1931 before the effects of the abandonment of free trade and of the gold standard had been felt.

The following figures illustrate the changing distribution of United Kingdom trade as between industrialised and raw-material-producing countries:

United Kingdom: Value of Trade in Each Quarter as Percentage of the Corresponding Quarter of Previous Year.

	Imports					Exports				
	1937				1938	1937				1938
	I	II	III	IV	I	I	II	III	IV	I
Ten industrialised countries ^a . . .	104.3	120.1	122.6	126.7	129.9	125.3	134.2	119.8	99.9	77.0
All other countries ^b . . .	117.6	125.4	126.3	115.6	98.6	108.9	124.4	117.9	115.9	107.4

^a Austria, Belgium, Czechoslovakia, France, Germany, Japan, Netherlands, Sweden, Switzerland and the United States.

^b Italy has been excluded from both groups on account of the disturbances to Anglo-Italian trade during 1936.

Imports from the industrialised countries showed a steady rise throughout 1937, whereas exports to these countries fell at the end of 1937, partly as a result of smaller purchases by the United States. On the other hand, exports to raw-material-producing countries continued on a high level throughout 1937, as a result of the expenditure by such countries of the large incomes earned from the export of raw materials in the first half of 1937.

The foreign trade of France has recently been much affected by the devaluation of the franc and by the internal difficulties of the French economy.¹ As the graph on page 130 shows, the excess of imports over exports increased very much after the devaluation of October 1936, and was as high as 18,380 million francs in 1937 in comparison with 5,478 million francs in 1935 and 9,922 million francs in 1936. In terms of gold values, imports in 1936 were 11% greater than in 1937, while exports were only 2.5% greater. Exports would have been encouraged by the devaluation of the franc, in the absence of the rise in wage costs and the increased scarcity of skilled labour which resulted from the policies described in Chapter II. Imports of raw materials during 1937 were stimulated by anticipation of further depreciation of the franc, and increased in quantum by about 8% in comparison with a 4% or 5% increase in industrial production. Largely as a result of the curtailment of home production after the introduction of the forty-hour week, coal imports rose by as much as 34%. The quantum of manufactured imports was 25% greater than in 1936, owing largely to purchases occurring

¹ Cf. Chapter I.

before August 1937, when the tariff reductions introduced in the autumn of 1936 were abrogated and new tariff increases were imposed.

During 1937, as can be seen from the graph on page 130, both imports and exports rose rapidly in Germany. Imports rose mainly as a result of larger purchases of foodstuffs,¹ which were partly due to comparatively poor German crops. At the same time, while there was some increase in the import of raw materials for the production of consumption goods, the most marked increases of raw-material imports were in metals and ores, for which the demand has recently increased considerably as a result of rearmament and capital investment:

Germany: Quantities imported of Certain Articles in 1937 as Percentage of 1929.

Iron ore	122	Cotton	73
Manganese ore	142	Wool	62
Other ores	153	Timber	28
Iron and steel, raw	121	Oil seeds	57
Copper, raw	100	Coal	58

The rise in exports was due almost entirely to increased exports of manufactured goods, practically all important classes of which — with the exception of certain textile goods — increased during 1937. The rapid expansion of Germany's export trade in motor-vehicles continued, and there was an increase of 79% in such exports between 1936 and 1937.

Since the end of 1937, as the graph on page 130 shows, German exports have fallen substantially as a result of the recession in business activity in other countries. German imports have, however, been reduced much less; and, for the first time since the beginning of 1935, an appreciable excess of imports has developed:

Germany: Excess of Imports (—) or of Exports (+) of Merchandise.

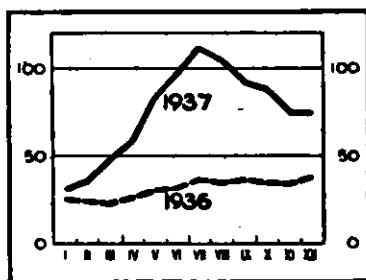
	RM. (000,000's).		
	1936	1937	1938
1st quarter	+ 81.3	+ 192.6	— 50.6
2nd quarter	+ 49.3	— 2.4	— 63.4
3rd quarter	+ 188.2	+ 122.4	....
4th quarter	+ 231.3	+ 130.3	....

¹ Imports of wheat rose from 74,000 tons to 1,219,000 tons, and of maize from 172,000 tons to 2,159,000 tons.

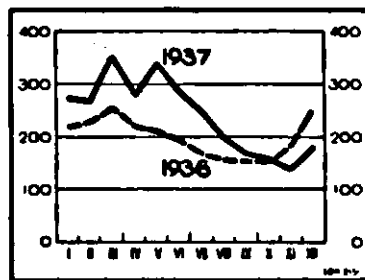
In the course of 1937 and the first months of 1938, there have been important fluctuations in Japanese trade, as can be seen from the graph on page 131. Imports rose to exceptionally high levels in the first half of 1937 before the outbreak of hostilities with China; but since the middle of that year they have been reduced, largely by restrictions imposed on the import of commodities which are not necessary for the prosecution of the war.¹ As the following graph shows, imports of ores and metals have remained high, while the import of other goods has been much reduced:

Japan: Monthly Import Values in Yen (000,000's).

Ores and metals.



Other goods.



Japanese exports, after rising for a number of years, were seriously reduced at the beginning of 1938 under the influence of the recession of demand in foreign markets, of unofficial boycotts and of increased difficulties in obtaining raw materials for the production of export goods.

As a result of these movements of trade, Japan experienced a very large import surplus during the first three quarters of 1937, which gave rise to the restriction of imports and to an export surplus in the fourth quarter of 1937. In the first quarter of 1938 there was a normal seasonal import surplus. At the same time, the shift in the composition of imports towards the more expensive goods caused the terms of trade to continue to move unfavourably to Japan even after the fall in raw-material prices since the second quarter of 1936:

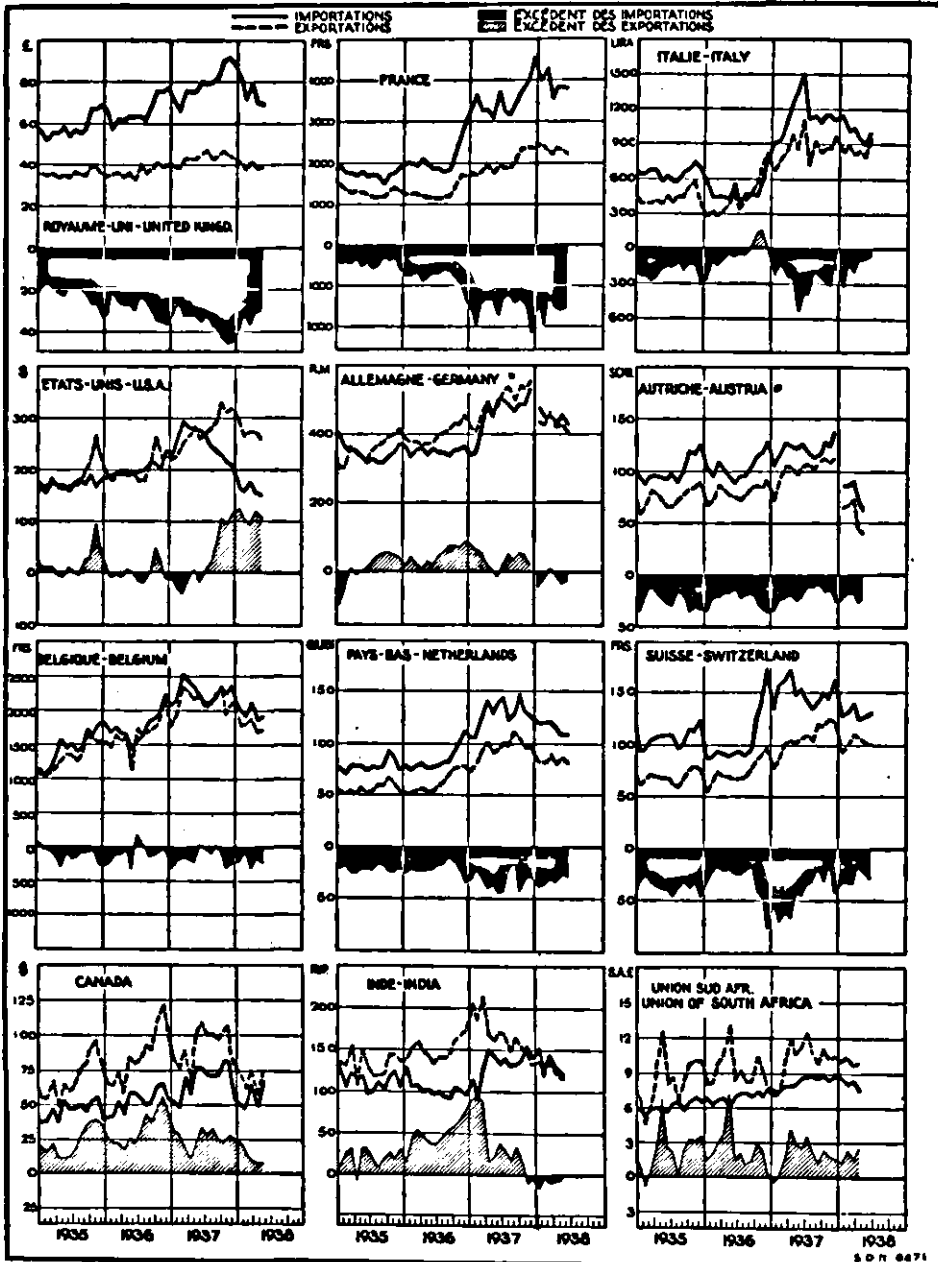
Quarterly Ratio between Japanese Export and Import Prices.
(1928 = 100.)

1936	1937				1938
IV	I	II	III	IV	I
67.2	66.6	62.0	56.5	53.8	61.3

¹ Cf. Chapter VIII.

Movement of the Foreign Trade of Certain Countries.

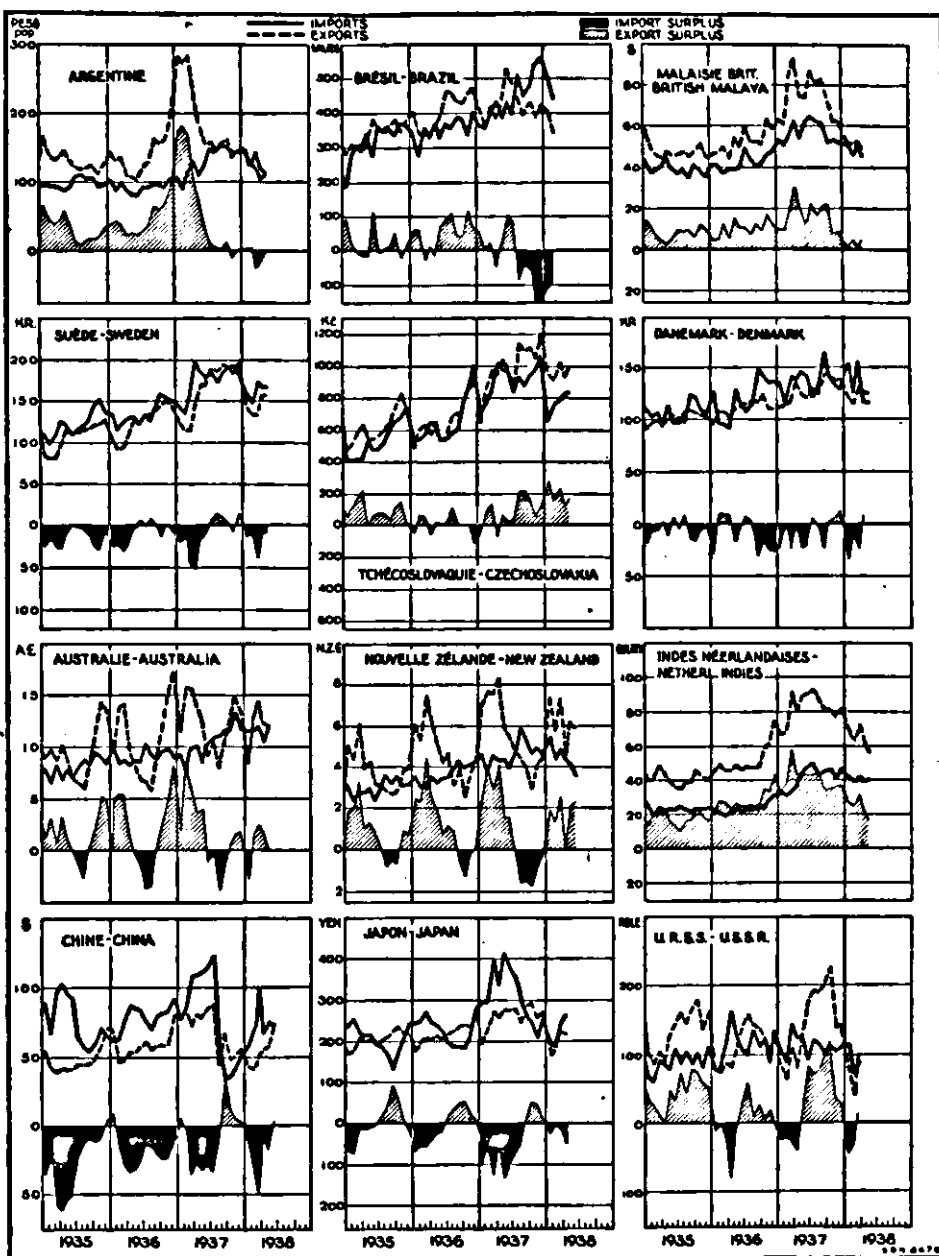
Values in national currencies (000,000's).



• *Germany*: since 1938, not including trade with Austria.
 • *Austria*: since 1938, not including trade with Germany.

Movement of the Foreign Trade of Certain Countries.

Values in national currencies (000,000's).

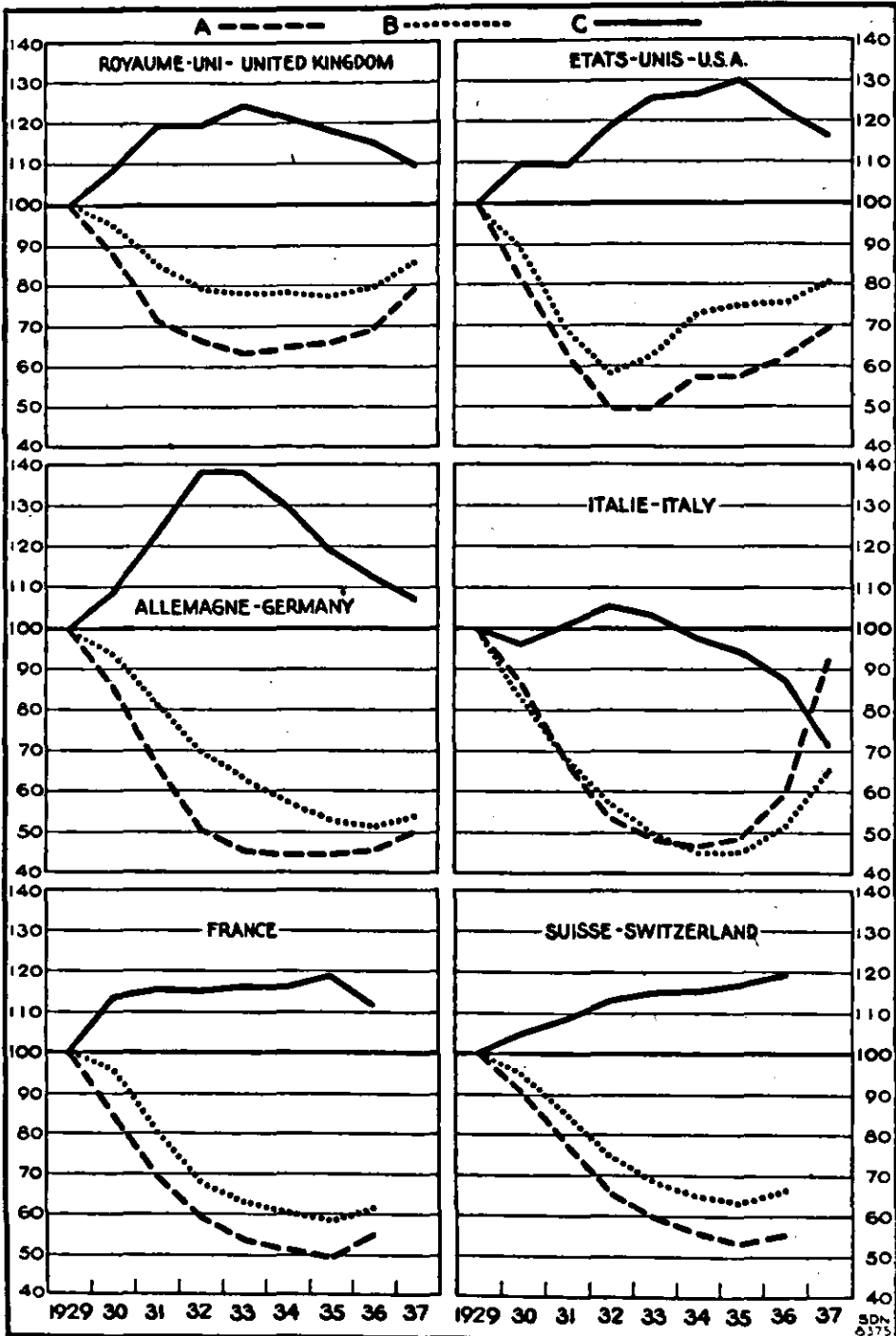


Import and Export Prices.

(1929 = 100.)

A Import prices.
B Export prices.

C Ratio of export to import prices.

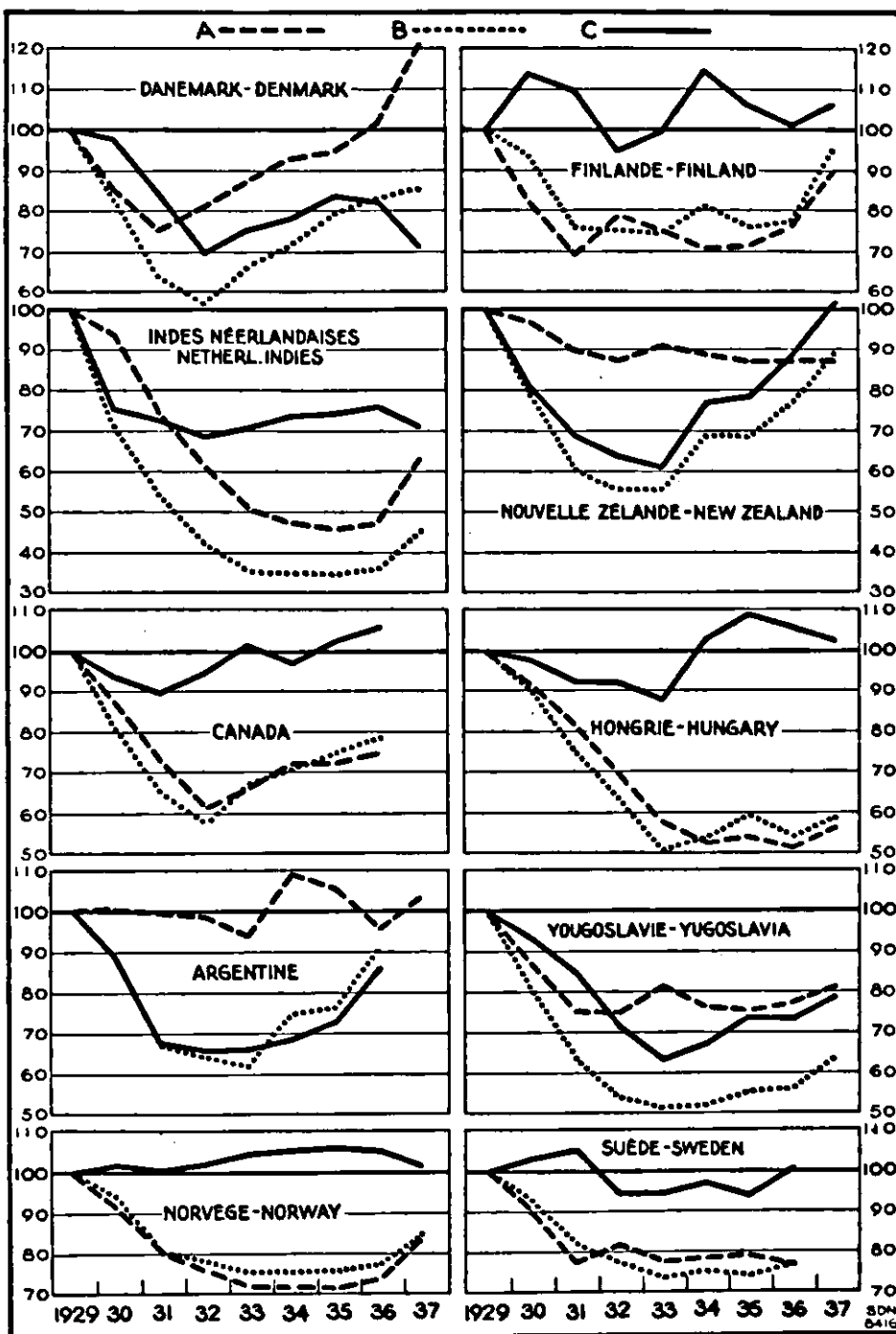


Import and Export Prices.

(1929 = 100.)

A Import prices.
B Export prices.

C Ratio of export to import prices.



TRADE OF THE PRIMARY PRODUCING COUNTRIES

The change in the trend of international trade during the period covered by this *Survey* has had serious consequences for the countries which rely primarily upon their exports of raw materials and agricultural products. It has already been shown (*cf.* page 120) that in the course of 1937 the terms of international trade turned seriously to the disadvantage of such countries as a result of the heavy fall in the price obtainable for primary products. In nearly every case the relation between the prices obtained for exports and the prices paid for imported goods were less advantageous to the primary producing countries in the second than in the first half of 1937.¹ The graphs on pages 132 and 133 show that the relation of export and import prices moved to the disadvantage of the primary producing countries during the slump from 1929 to 1933, but that in many cases in the process of recovery up to 1936 it had moved back a long way towards the 1929 level. In the course of 1937 this trend was again abruptly changed.

From the middle of 1936 until the second quarter of 1937, the primary producing countries experienced a strong and rising demand for their exports; but, with the break in commodity prices in the second quarter of 1937 and with the fall in the American demand for raw materials² in the second half of 1937, the value of the exports of the primary producing countries was sharply reduced. There is usually some considerable time-lag between a change in the incomes earned by the primary producing countries and the consequent change in their purchases of imports; and this time-lag has been well illustrated by recent events, as the demand for imports by the primary producing countries has remained on a high, and often on a rising, level for some time after the fall in their exports. This time-lag is illustrated by the following figures,³ which show the percentage variations in exports and in imports of certain primary producing countries between the beginning of 1937 and the beginning of 1938:

¹ Denmark, however, which imports cereals and exports animal foodstuffs, enjoyed better terms of trade during the second half of 1937 as a result of the heavy fall in cereal prices.

² The importance of the United States as a purchaser of raw materials is illustrated by the following examples. In the case of rubber, industrial consumption in the United States, in 1936, accounted for more than half of the total world consumption; while in the case of copper, lead and tin, the share of the United States in world consumption was about a third, slightly less than a third and nearly a half respectively. The reduction in the American demand for raw materials since the middle of 1937 has been a most important cause both of the fall in the prices of primary products and also of the adverse trade balances of the primary producing countries. *Cf.* League of Nations, *World Production and Prices, 1937/38*, Chapter VI.

³ *Cf.* *L'Activité Economique*. April 1938, page 82.

Percentage Rise (+) or Fall (–) in the Exports and Imports of Certain Primary Producing Countries between the First Quarter of 1937 and the First Quarter of 1938.

	Percentage change in exports	Percentage change in imports
Argentine	– 54.3	+ 34.7
Australia	– 15.8	+ 30.0
Brazil	– 6.1	+ 31.8
Canada	– 16.2	– 5.7
Egypt	– 36.0	+ 8.2
India ^a	– 12.9	+ 46.4
Netherlands Indies	– 10.3	+ 23.8
New Zealand	– 7.8	+ 14.6

^a Including Burma.

It will be seen that, as a general rule, imports at the beginning of 1938 remained higher than at the beginning of 1937, although exports had already fallen to considerably lower levels.

As a result of these movements of trade, the raw-material-producing countries obtained large export surpluses during the first months of 1937; but in most cases these export surpluses had greatly diminished, or had actually turned into import surpluses, by the end of the year. These changes are illustrated in the graphs on pages 130 and 131. The trend is most noticeable in the cases of Argentine, Brazil and India, where export surpluses have given place to import surpluses. The heavy exports from Argentine in the first months of 1937 were due to the combination of good cereal crops with high prices and an exceptional demand owing to the poor crops in North America. The fall in the value of Brazilian exports in the second half of 1937 was largely due to the breakdown of the coffee valorisation scheme to which reference is made in Chapter VIII. But, in addition to these outstanding examples, the same trend can be observed in the case of most of the raw-material-producing countries shown in the graph. Sooner or later the raw-material-producing countries will adjust this adverse change in their balances of trade by reducing their imports of industrial goods as a result of their reduced incomes from exports; and this, in turn, will exert a deflationary pressure upon the industrialised countries. Such a series of deflationary repercussions seems inevitable unless some measure of recovery of business activity and of purchasing power is achieved in the main industrialised countries.

Estimates of National Income.

in national currencies (000,000's).

Countries	Currencies	1929	1930	1931	1932	1933	1934	1935	1936	1937
Australia ^a	A.£	645	566	460	438	458	512	518	560	610-25
Austria	Sch.	7,249	7,407	7,040	6,048	5,366	5,421	...	...	...
Belgium	B. fr.	...	68,490	...	50,000	...	49,710	...	60,200	65,920
Bulgaria	Leva	56,207	48,641	44,561	39,273	35,633	34,564	36,569	...	...
Canada	C.\$.	6,072	5,335	4,100	3,370	3,193	3,808	...	...	...
Denmark	Kr.	3,700	3,750	3,550	3,400	3,550	3,850	...	...	...
Estonia	E.Kr.	342	315	260	224	249	259	284	318	...
Finland ^a	Mk.	18.3	16.6	13.8	13.9	15.2	17.9	18.8	20.5-21.0	...
France ^a	Fr.	245	243	229	206	199	184	172	189	...
Germany	RM.	75,949	70,223	57,458	45,175	46,590	52,710	57,895	62,623	68,500
Japan	Yen	11,918	10,470	10,043	10,229	11,469	12,029	12,482	13,109	...
Netherlands	Fl.	5,768	5,525	4,787	4,320	4,283	4,187	4,131	...	...
New Zealand ^b	NZ.£	162.5	141.0	112.0	104.0	118.5	126.0	...	...	...
Norway	Kr.	2,200	2,197	1,994	1,934	1,902	1,948	1,954	2,076	2,306
Sweden	Kr.	.	7,630	6,926	6,400	6,454	7,262	7,800	8,591	...
United Kingdom	£	4,384	4,318	3,889	3,844	3,962	4,238	4,530	...	...
United States ^a	\$	81.1	68.3	53.8	40.0	42.3	50.1	55.2	63.5	69.8
U.S.S.R. ^c	R.	28,900	...	...	45,500	48,500	55,800	65,700	83,100	95,700

^a Billiards.

^a Year beginning July 1st.

^b Year beginning April 1st.

^c At 1926/27 prices.

Source:

Australia: *Bank of New South Wales*, Nov. 3rd, 1937.

Austria: *Institut für Konjunkturforschung*, June 26th, 1937.

Belgium: *Bulletin de l'Institut de recherches économiques*, Feb. 1938.

Bulgaria: *Statistical Institute of Economic Research*, 1937, No. 2.

Canada: *The Canada Year-Book*.

Denmark: *Statistik Aarbog*.

Estonia: *Estonian Institute for Economic Research*.

Finland: *Bank of Finland*, Monthly Bulletin, No. 2, 1937.

France: *La France Economique*.

Germany: *Statistisches Handbuch*.

Japan: *Mitsubishi Economic Research Bureau*, Monthly Circular, April 1937.

Netherlands: *Private estimates by Dr. Derksen*.

New Zealand: *Economic Record*, Dec. 1936.

Norway: *Norges Bank Monthly Report*, March 1938.

Sweden: *Estimates by Prof. Erik Lindahl*.

United Kingdom: Colin Clark; *National Income and Outlay*.

United States: *U.S. Department of Commerce*.

U.S.S.R.: *Monthly review* issued by the U.S.S.R. Trade Delegation in the United Kingdom.

Chapter VII

BALANCES OF PAYMENTS AND FOREIGN EXCHANGE

BALANCES OF PAYMENTS ON ACCOUNT OF CURRENT ITEMS

Economic events in any particular country or group of countries exert a direct influence upon other countries through the balance of international payments. Thus, falling prices, incomes and purchasing power in the United States lead to a reduction in American payments to other countries for the purchase of imports, for the finance of tourist expenditure and for other purposes. In this way, the reduction of business activity is communicated to other countries, which will lose reserves of gold and foreign assets and so be subjected to a deflationary pressure unless other measures are taken to preserve a balance in their international payments. Such measures may take the form either of a depreciation of their currencies, or of an internal deflation of prices and incomes with its accompanying depressing influences on the level of business activity, or of competitive protective devices such as increased tariffs, quotas and exchange controls, which will achieve temporary relief for individual countries until other countries retaliate with similar measures. In the absence of successful internal measures to counteract the depression in the countries with an active balance of payments, this mechanism will cause a depression of business activity to spread over all countries.

This mechanism has, however, been complicated in recent years by abnormal movements of short-term capital from one country to another. As will be seen in a later section of this chapter, the problem of the balance of payments of any one country is liable at present to be greatly intensified by large-

scale shifts of money from one country to another as a result of a sense of insecurity or because of the expectation of currency depreciation. The problem of the balance of payments for countries in a weak position may be greatly intensified by this factor; while countries whose position would otherwise be reasonably secure may experience great difficulties from such a flight of "hot" money.

In discussing the balance of payments of different countries, a clear distinction may be drawn between two groups of countries: on the one hand, the important creditor countries, which are highly industrialised and which export manufactured products, and, on the other hand, the debtor countries, which rely primarily upon the production of foodstuffs and raw materials.¹ Germany — being both highly industrialised and an important debtor country — is the most important country standing outside this classification. The funds which the creditor countries have available to lend abroad are composed of their net receipts on current account in their balances of payments — *i.e.*, of their net receipts from interest and dividends and from the sale of services to other countries *minus* the payments which they must make to finance the excess of their imports over their exports of commodities. If the creditors lend less than this to the debtors, the difference must be financed by a transfer of gold or of balances of money from the debtors to the creditors. There are, therefore, two important ways in which the creditor countries may exert a deflationary pressure upon the debtors — either by purchasing less from the debtors or by reducing the amount which they lend to the debtors.

The net receipts or payments on account of the current items in the balance of payments of the three chief creditor countries and of a number of debtor countries are shown in the table on the next page.

¹ The following table gives the amount received by the main creditor countries, and paid by the main debtor countries, in interest and dividends during 1936:

Amounts received (+) or paid (-) in Dividends and Interest during 1936.

Old gold \$ (000,000's).

United Kingdom	+ 573.6	New Zealand ^b	- 22.5	India ^c	- 71.6
United States	+ 195.0	Netherlands		Australia ^d	- 84.4
France	+ 149.8	Indies	- 44.6	Argentina	- 94.1
Hungary ^a	- 4.8	Union of		Germany ^a	- 131.0
Poland ^a	- 16.3	South Africa ^a	- 51.5	Canada	- 138.2

^a Figures for 1935.
^b Year ending March 1936.
^c Year ending March 1937.
^d Year ending June 1936.

Surplus of Receipts (+) or of Payments (—) in the Balances of Payments on Account of Current Items of Main Creditor and Debtor Countries.

	Old gold \$ (000,000's).				
	1929	1932	1934	1936	1937
Creditor countries: ^a					
United Kingdom . . .	+ 497	— 173	+ 8	— 56	— 121
United States	+ 235	+ 40	+ 274	— 89	— 29
France	+ 137	— 193	— 45	— 111	— 146
Debtor countries: ^b					
Canada	— 224	— 21	+ 40	+ 192	+ 127
Germany	— 572	+ 60	— 142 ^c	...	...
Argentina	— 159	— 14	— 5	+ 7	...
Australia ^e	— 200	+ 28	+ 21	— 19	...
India ^d	+ 23	— 139	— 71	+ 20	...
Union of South Africa	— 68	+ 79	+ 17	...	...
Netherlands Indies . .	— 60	— 35	+ 21	+ 45	+ 70
New Zealand ^d	— 55	+ 5	+ 2	...	...
Poland	— 59	+ 5	+ 17	...	...
Hungary	— 37	— 2	.	...	...

^a Figures represent the surplus of receipts or payments on account of goods and services with certain minor adjustments (*Cf. League of Nations, Balances of Payments, 1936, page 16*).

^b Figures represent the surplus of receipts or payments on account of goods and services with the addition, in the case of gold-producing countries, of the value of gold produced.

^c Years ending June 30th.

^d Years beginning April 1st.

^e This figure appears to include sums in respect of which scrip or funding bonds have been distributed to foreigners in place of the actual transfer of interest and dividends.

Between 1929 and 1937 a marked change has taken place in the relations between the debtor and creditor countries. In the years before 1929, the creditor countries were lending abroad on a large scale, and this flow of capital to the debtor countries was financed out of the excess of the creditors' receipts from the debtors on account of current items. But, in 1936 and 1937, the creditor countries were no longer lending abroad, and past loans and debts were in process of repayment by the debtor countries; and the debtors were financing this repayment of capital out of their excess receipts from the creditor countries on account of current transactions. This process of readjustment in the balances of payments may be divided into four stages. Between 1928 and 1932 lending by the creditor countries ceased, and, with the onset of the world depression, loans were recalled from the debtor countries. This

exercised a strong deflationary pressure upon the debtor countries; and these countries, in order to obtain funds to meet their obligations, were forced to cut down their purchases of the creditor countries' goods and services, to export their goods to the creditor countries in large amounts at lower prices, and to ship gold. If these measures failed, default on interest or amortisation resulted. By these means, the debtor countries had reduced their surplus of payments or had achieved a surplus of receipts on current account by 1932,¹ and the creditor countries' excess of receipts had been turned into an excess of payments. In the succeeding period (1932-1934), the position of the creditor countries was again reversed. The United Kingdom depreciated the exchange value of the pound and adopted a policy of import restrictions to adjust its balance of payments in 1931; and, in 1933, the United States devalued the dollar. These measures enabled the creditor countries to regain an excess of receipts in their balances of payments on current account. During the same period, as the table on page 139 shows, a number of debtor countries were also able to improve their balance of payments on current account; but the measures of protection and devaluation in the creditor countries adversely affected some debtor countries, and, in particular, Germany, which, after achieving a substantial excess of receipts on current account in 1931 and 1932, experienced again a large excess of payments in 1934.

Between 1934 and the middle of 1937, the position of the debtor countries was greatly eased by the progress of recovery in the industrialised creditor countries, whose expenditure on primary products rose rapidly as their demand increased and as the prices of primary products recovered. In 1936 and 1937, the creditor countries' balance of payments again showed a large excess of payments,² and the net receipts of the debtor countries improved still further. The graph on the next page illustrates these changes in the balance of payments on current account for the three main creditor countries. It can be seen that between 1934 and 1937, the most important change has been the increase in the creditor countries' excess of imports over exports. This increase has been offset to some extent by a gradual rise in their receipts of dividends and interest as conditions improved in the debtor countries, and between 1936 and 1937 by a substantial increase in receipts from other services, which has been largely due to the high freights earned in shipping.

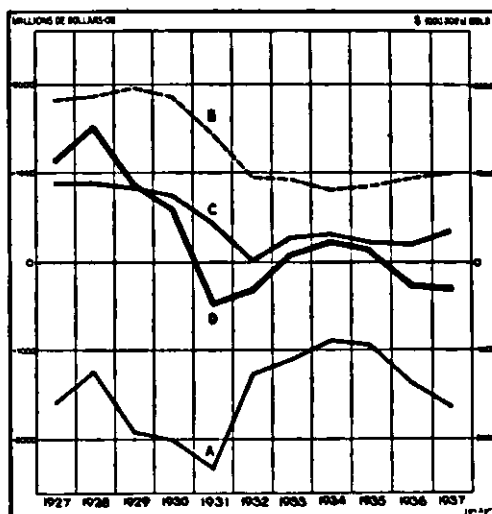
¹ India, which is an important exception to this statement, was able to finance a large excess of payments by the dishoarding and export of large quantities of gold.

² The United States experienced a net excess of payments on current account for the first time in 1936.

In 1936 and 1937, the debtor countries had an excess of receipts over payments in their balances of payments on current account; but, in many cases, their position was subjected to a sharp reversal in the course of 1937 as a result of changes in the balances of trade.¹ Owing largely to the rapid fall in the demand for raw materials by the United States of America, the excess of American imports has given place to a very large excess of exports; and, although the import surpluses of the United Kingdom and France remain at a high level, the exports of many primary producing countries — in particular, of India and the South-American countries — have diminished rapidly. As these primary producing countries continued to spend freely on imports in consequence of the high incomes gained from the previous period of high demand for their exports, their balances of trade and so their balances of payments became increasingly unfavourable after the middle of 1937.

Combined Balances on Account of Current Payments and Receipts of the United States, the United Kingdom and France.

- A Goods.
- B Interest and dividends.
- C Other services.
- D Total current items.



GOLD AND CAPITAL MOVEMENTS

It has been seen that, in 1936 and 1937, each of the three chief creditor countries experienced an excess of payments over receipts on account of the current items in their balances of payments. In the absence of an inflow of capital, the financing of these excess payments should have caused a loss of gold by the creditor countries. In fact, however, while France lost gold during 1936 and 1937 in sums greater than her net excess of payments on account of current items, the United States and the United Kingdom both gained gold in large amounts,

¹ Cf. Chapter VI for a full discussion of these changes.

as the following figures show:

	Old gold \$ (000,000's).					
	United States		United Kingdom		France	
	1936	1937	1936	1937	1936	1937
Excess of payments (—) or receipts (+) on ac- count of current items in the balance of pay- ments	— 89	— 29	— 56	— 121		
Net payments for im- ports (—) or receipts for exports (+) of:					— 111	— 146
(a) Silver *	— 106	— 49	+ 3	— 31		
(b) Gold	— 608	— 818	— 671	— 234	+ 809	...
Balance to be explained by capital outflow (—) or inflow (+) . .	+ 803	+ 896	+ 724	+ 386	— 698	...

* The trade in silver has not been regarded as a "current" item in the international accounts of the United States (because of her large imports of silver for monetary purposes in recent years) and the United Kingdom (because of the large variations in the stocks of silver held in that country).

Foreign lending on long term by the main creditor countries, through new foreign capital issues, remained in 1937 at levels far below those which ruled before 1929. In fact, when account is taken of the redemption and amortisation of foreign bonds by the debtor countries, long-term capital is in process of repayment to the creditor countries.

New Foreign Capital Issues.¹

	Old gold \$ (000,000's).		
	1928	1936	1937
United States	1,251	13.6	2.4
United Kingdom . . .	720	95.3	96.4
Switzerland	18	—	26.0
Netherlands	121	—	9.5

Net Outflow (—) or Inflow (+) of Funds on Account of Capital Issues and Amortisation.²

	Old gold \$ (000,000's).	
	1929	1936
United States	— 374.0	+ 93.5
United Kingdom	— 228.7	+ 135.4

¹ Figures from *Eighth Annual Report of the Bank for International Settlements*, page 68, converted into old gold dollars.

² Figures from *League of Nations Balances of Payments, 1936*, page 25, converted into old gold dollars.

These repayments of long-term loans by the debtor countries account only for a small part of the net inflow of capital into the United States and the United Kingdom. The remainder is to be explained by the purchase of existing securities with foreign funds and by movements of short-term money, a large part of which reflects the flight of French capital into dollars and pounds.

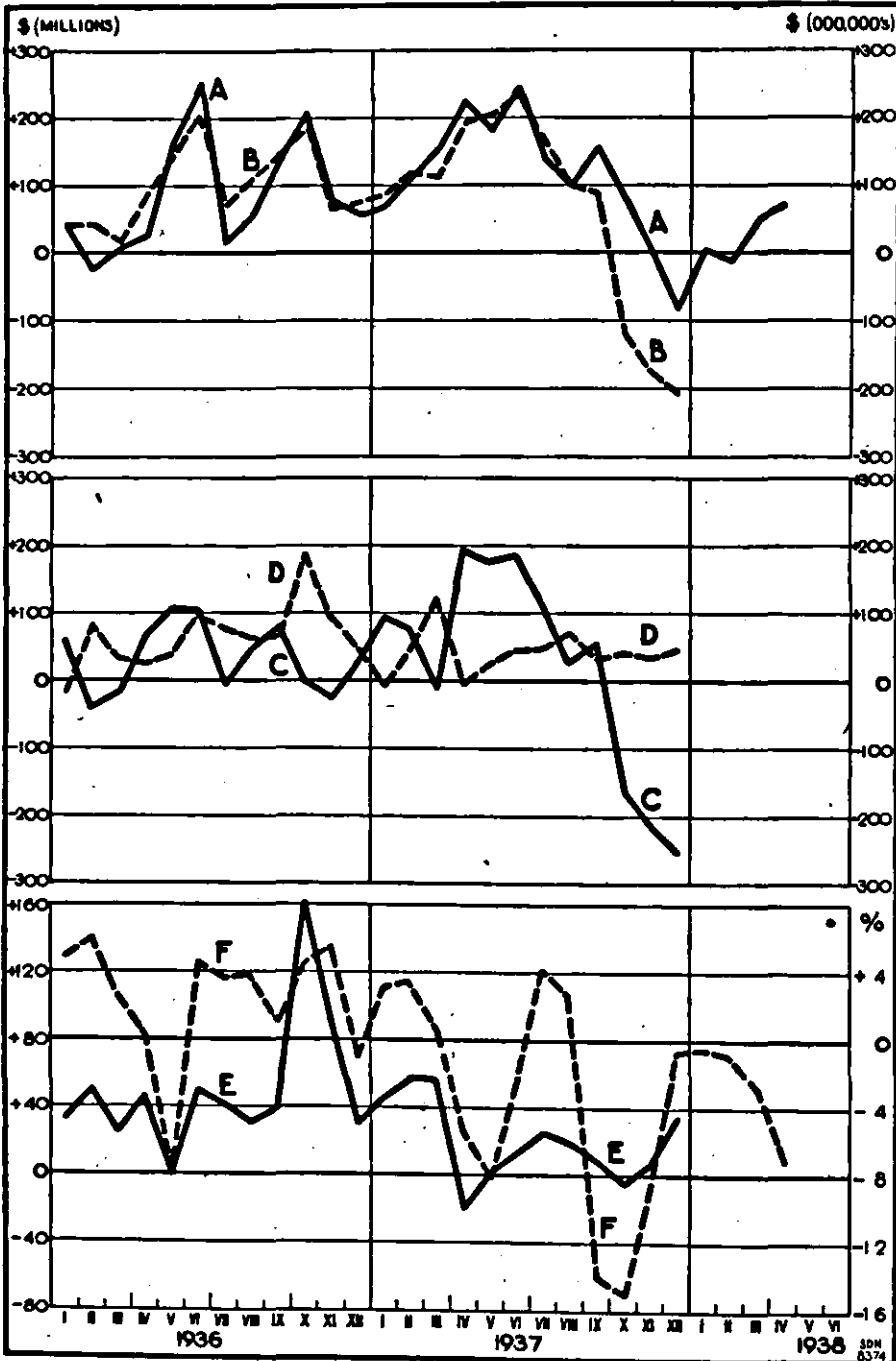
The changes in the capital imports into the United States are demonstrated by the graph on the next page. From the first section of the graph, it can be seen that a substantial inflow of capital occurred until the autumn of 1937, and that the gold inflow into the United States depended closely upon capital movements. During the second quarter of 1937, there was a particularly large movement of capital into the United States, which was due to the flight from gold to dollar balances because of the belief that the gold value of the dollar was about to be appreciated;¹ but during the last quarter of 1937, with the serious setback in business activity and the fear that the dollar might in consequence be depreciated, there was a considerable outflow of capital. There was, however, no corresponding outflow of gold, and this discrepancy is to be explained by the payments made to the United States for the large excess of American commodity exports which developed at this time as a result of the depression of American incomes and prices.² From the second section of the graph, it can be seen that this outflow of capital in the last quarter of 1937 took the form of a removal of bank balances, and that some foreign purchase of securities continued in the United States; and this suggests that the capital outflow was influenced rather by fears of a depreciation of the dollar than by the expectation of falling values of American securities. Up to the last quarter of 1937 the graph shows a marked contrary movement between the amount of banking funds held in the United States and the purchase of securities by foreigners. This indicates that purchases of securities by foreigners were largely independent of the total capital inflow, so that the foreign holdings of bank balances were increased by sales, and reduced by purchases, of securities. The United States securities bought and sold by foreigners during the last few years were mainly shares; and the bottom section of the graph on the next page shows that there has been a close connection between foreign purchases of United States securities and movements in the prices of

¹ This "gold scare" and subsequent "dollar scare" are discussed in a later section of this chapter.

² Cf. Chapter VI.

Net Inflow of Gold and Capital into the United States.

- A Net gold imports.^a B Net inflow of capital.^b
 C Net inflow of banking funds. D Net foreign purchases of securities.
 E Net foreign purchases of United States securities (left-hand scale).
 F Percentage month-to-month variation in share prices in the United States (right-hand scale).



^a Including earmarking transactions.
^b Excluding certain items of small importance for which monthly figures are not available.

shares.¹ The total of purchases and sales for foreign account appears recently to have accounted for as much as 15% of the total transactions in shares on the United States stock exchange; and it is therefore quite possible that these foreign purchases and sales have exerted a direct influence on American share prices. At the same time, it is also possible that the causal connection was to some extent in the reverse direction, and that the speculative foreign funds were invested in securities at certain times because security prices were then rising.

The following table shows the countries from which the capital movements into the United States are recorded:

	United Kingdom	France	Netherlands	Switzerland	Other Europe	Canada	Latin America	Far East
	(\$ (000,000's))							
1937:								
1st quarter . . .	98	9	37	28	41	— 9	135	—14
2nd quarter . . .	152	35	90	256	34	—11	45	24
3rd quarter . . .	27	— 5	34	118	78	45	26	27
4th quarter . . .	—112	—56	—79	—130	—52	—70	3	3
1938:								
1st quarter . . .	— 56	—15	—52	— 63	— 1	18	—10	—37

The heavy inflow of capital in the first half of 1937 was in part due to the accumulation of dollar balances by the Latin-American countries as a result of their favourable balance of trade; but, in the main, it was due to an inflow from Europe, and, in particular, from Switzerland, as gold was sold for dollars at the time of the gold scare.² The outflow of funds in the last quarter of 1937 was in the main to European countries, and included some repatriation of funds to France.

Similar figures to illustrate the inflow of funds into the United Kingdom are not available. Some part of the inflow of capital is to be explained by the increases in the reserves held by the "sterling group" countries in the form of balances of money in London. The reserves of foreign assets of fifteen "sterling group" countries — which may be assumed to keep these reserves predominantly in the form of balances of money in London — increased by £11 million during 1936 and £32½ million during 1937.³ The remainder of the import of capital into the United Kingdom, apart from the redemption of foreign bonds by the debtor countries to which reference

¹ The two curves continued to fluctuate in the same direction even during the stock exchange slump in the autumn of 1937, although share prices fluctuated more violently in relation to foreign purchases of securities.

² Cf. *Eighth Annual Report of the Bank for International Settlements*, page 62.

³ Cf. League of Nations, *Money and Banking, 1937/38*, Volume I, page 23.

has already been made, must be mainly accounted for by the inflow of "hot" money and of refugee funds from France and other countries.

Since the devaluation of their currencies in October 1936, there has been a considerable repatriation of capital and inflow of foreign capital into Switzerland and the Netherlands. As will be seen later, the central gold and foreign asset reserves of both these countries have risen considerably. Switzerland experienced an outflow of funds, partly to England, but chiefly to the United States, in the second quarter of 1937; but there was a large inflow of funds in the second half of the year. Sweden also has experienced an inflow of capital, particularly during the first part of 1937, when the possibility of appreciating the exchange value of the krona was discussed as a method of controlling the development of undesirable boom conditions. Both Switzerland and Sweden have taken measures to discourage the holding of refugee "hot" money in their currencies by reducing the rate of interest, or by levying charges, on foreign deposits held in their banks.

The most important countries which have recently experienced an outflow of speculative capital are France and, in recent months, Belgium. As has already been seen, France experienced a loss of gold during 1937, partly as a result of an excess of payments over receipts on current account in her balance of payments, but mainly as a result of an outflow of capital. This outflow of capital has been caused partly by the sense of insecurity due to the internal economic difficulties discussed in Chapter I, and partly by the expectation of further depreciations of the franc due to the foreign exchange difficulties to which reference is made in a later section of this chapter. There was some considerable repatriation of French funds in the last quarter of 1937, estimated at 10,000 million francs;¹ and again in May 1938, after the devaluation of the franc to a lower limit of 179 francs to the pound, an inflow of funds occurred, estimated at 18,000 million francs.² It is estimated that the export of capital (valued in francs of the old parity) reached 16,350 million in 1935, 18,000 million in 1936, and 6,000 million in 1937; and in the first quarter of 1938 a further 2,000 million francs of capital were estimated to have been exported.³ Conditions in America reacted adversely on Belgian economic activity, and this, combined with the continued depreciation of the French franc, led to doubts as to the foreign exchange

¹ Cf. *L'Activité économique*, January 1938, page 320.

² Cf. *The Economist*, May 14th, page 363.

³ Cf. *L'Activité économique*, April 1938, page 20.

position of Belgium and caused a considerable movement of speculative funds from that country. As the graph on page 97 shows, Belgium lost gold on a large scale in the first months of 1938; and, in May 1938, the devaluation of the French franc to a lower limit of 179 francs to the pound caused a renewed movement of funds from Belgium and a renewed pressure on her exchange position.

The capital and gold movements discussed in this section have been reflected in changes in the central gold and foreign asset reserves of the different countries, although some part of the gold movements have been into or out of hidden reserves, such as Exchange Equalisation Funds. The following table¹ shows the most important changes in published gold reserves in the course of 1937 with corresponding figures for 1936:

Loss (—) or Gain (+) in Reported Gold Reserves of Banks of Issue and Governments.

	Old gold \$ (000,000's).	
	During 1936	During 1937
United States	+ 670.7	+ 887.7
Netherlands	+ 30.8	+ 260.0
United Kingdom	+ 554.1	+ 62.1
Java	+ 3.6	+ 11.2
Union of South Africa . .	— 5.3	— 8.3
Mexico	+ 1.2	— 8.9
Norway	+ 8.3	— 9.5
Argentine	+ 33.7	— 18.9
Belgium	+ 14.8	— 20.7
Japan	+ 22.5	— 119.4
France	— 829.4	— 253.5

The largest gains were experienced by the United States, the Netherlands and the United Kingdom, into all of which countries there was an inflow of capital in 1937. The largest losses were those of France, which continued to experience a flight of capital, and Japan, which sold gold abroad in order to aid the financing of abnormally large commodity imports both immediately before and during the war against China.

RENEWED HOARDING OF GOLD

In addition to these changes in official gold reserves, there have been important changes in the quantity of gold held in unpublished official reserves and in private hoards. From the

¹ Figures from the *Eighth Annual Report of the Bank for International Settlements, 1938*, page 49, converted into dollars of the old gold content. Monthly figures of recent changes of gold reserves are given in Chapter V in the graph on page 97.

time of the devaluation of the currencies of the gold bloc in October 1936 until the middle of 1937, gold was dishoarded by private individuals. At first, this dishoarding occurred because of the greater opportunity for the profitable employment of capital in industry as prices and profits rose after the currency devaluation. But at the beginning of the second quarter of 1937, this private dishoarding of gold was accentuated by the development of a "gold scare". It was rumoured that the United States, which was still at some cost sterilising large gold imports in its inactive gold fund, was on the point of appreciating the gold value of the dollar and of lowering the dollar price offered for gold as a means of controlling the excessive rise in commodity prices which had occurred in recent months. The possibility of a lowered price of gold was increased by the fact that, during the first half of 1937, considerable quantities of gold were exported for sale by the Union of Soviet Socialist Republics. As a result of this rumour, private hoards of gold were sold for conversion into dollars and other currencies whose gold value might be expected to appreciate. To offset these sales of gold, the British Exchange Equalisation Fund bought gold on a large scale, and, in June 1937, the resources of the Fund were raised from £375 million to £575 million to enable it to continue to absorb gold.

During the second half of 1937, these conditions were sharply reversed. As a consequence of the slump in business activity in the United States in the autumn of 1937, funds were withdrawn from the United States and it was thought that, as in 1933, the dollar might again be depreciated in gold value as a method of counteracting the fall in prices. A "dollar scare" developed; and funds which were withdrawn from the United States were invested in new private hoards of gold, while, at the same time, a number of monetary authorities converted their foreign assets into gold. It has been estimated¹ that, valued in dollars of the old gold content, \$900 million to \$1,200 million of gold were held in private hoards (outside the East) at the end of September 1936, that approximately \$300 million of gold were dishoarded from these private holdings during the last quarter of 1936 and a further \$270 million during the first half of 1937, and that some \$90 million of gold were reinvested in private gold hoards in the last half of 1937.

These sales and subsequent purchases of gold exerted a great influence on the London gold market, where the price of gold is determined by the forces of supply and demand in

¹ *Eighth Annual Report of the Bank for International Settlements*, pages 44 ff. The figures have been converted from dollars of the present gold content into dollars of the old gold content.

a free market under the influence of purchases and sales of gold by the Exchange Equalisation Fund. Since, however, the United States Treasury maintains a fixed buying price for gold in terms of dollars, the sterling price of gold in London has normally to adjust itself to a level corresponding to the current sterling-dollar exchange rate. When the sterling price of gold in London, converted into dollars at the current rate of exchange, is lower than the dollar price of gold in New York,¹ it becomes profitable to purchase gold in London for sale in the United States; and the price of gold in London is said to be at a discount below the "shipping parity". It is, therefore, normally impossible for the price of gold to fall much below this "shipping parity"; for the consequent purchases of gold for shipment to the United States will tend to raise the price of gold, while, at the same time, the exchange into pounds of the dollars so obtained will cause the dollar to depreciate in terms of sterling and will so tend to reduce the "shipping parity" price of gold in London.

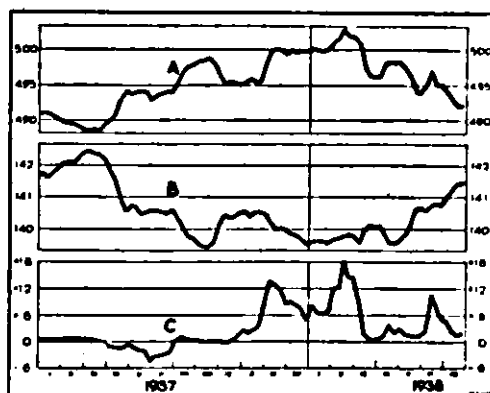
The effect of the dishoarding and renewed hoarding of gold upon the sterling-dollar exchange rate, the price of gold and the discount of premium of this price in relation to the "shipping parity" is illustrated in the accompanying graph.²

The effect exercised by the fixed American price of gold upon the relationship between the dollar-sterling exchange rate and the price of gold is clearly illustrated by the contrary movements of the two top curves. When, for example, the dollar price of sterling rises, the sterling price of gold tends to fall, so that after conversion into dollars at the higher dollar price of sterling it will be equal to the fixed dollar price of gold. In effect, the discounts or premia shown in line C represent the extent

The Dollar Exchange and the Gold Market in London.

(Weekly averages.)

- A Dollar-sterling rate of exchange.
- B Price of gold (in shillings and pence per fine ounce).
- C "Discount" (—) or "premium" (+) (in pence per fine ounce).



¹ After deducting the various costs involved in transporting the gold to, and selling it in, New York.

² Cf. League of Nations, *Money and Banking*, 1937/38, Volume I, pages 24 ff.

to which the opposite movements of lines A and B failed to compensate each other. The graph shows that the price of gold in London fell as a result of the sales of gold from private hoards from April to June 1937, and that a discount appeared below the "shipping parity". At this time, the fear that the fixed dollar price of gold might be reduced during the shipment of gold to the United States prevented the purchase of gold for shipment to the United States, and so made the continuation of the discount possible. It is to be observed that, in April 1937, the discount appeared through a fall in the price of gold — which was a natural result of the sale of dishoarded gold — accompanied by a rise in the dollar-sterling exchange rate, which was insufficient to offset the lower gold price. It is at first sight surprising that the exchange value of the dollar should have depreciated at this time, when there were heavy purchases of dollars on the part of the speculators who had sold gold in order to buy dollars. There were, however, three factors which prevented an appreciation, and actually caused some depreciation, of the exchange value of the dollar. In the first place, in the absence of private shipments of gold to the United States, the British Exchange Equalisation Fund probably eased the transfer of funds by selling gold to the United States for dollars, the exchange of which into pounds prevented an appreciation of the dollar. Secondly, at this time, there was a considerable excess of American imports over American exports, the financing of which involved the sale of dollars in purchase of other currencies. Thirdly, from March 1937 onwards, substantial shipments of Japanese gold were sold in the United States, and the sale of the dollars so obtained in order to purchase sterling and other currencies to finance Japanese imports was a factor causing the dollar to depreciate.

As the graph shows, conditions were sharply reversed in the last quarter of 1937, when the price of gold in London rose considerably above the "shipping parity". Dollars were sold at this time to finance the repatriation of foreign funds as a result of the "dollar scare", when speculators feared that the gold value of the dollar might be lowered; and this caused a depreciation of the exchange value of the dollar without a corresponding fall in the London price of gold. In consequence, the price of gold rose to a premium over the shipping parity.¹

¹ There are two reasons why this premium was not automatically reduced by the shipment of American gold for sale to London. In the first place, the "shipping parity" is the price at which it is profitable to ship gold from London to the United States; and the premium above this parity must rise to about 22 pence before it is profitable to incur the costs of shipping gold from the United States to London. In the second place, gold is not sold by the American Treasury to private dealers, but only to the central banks or Treasuries of the countries adhering to the Tripartite Monetary Declaration of 1936, so that the shipment of gold from the United States depends upon the action of these monetary authorities and not upon the profit motive of private dealers.

In May 1938, funds flowed to the United States and the dollar appreciated as a result of political tension in Europe. But, in June, there was again some depreciation of the dollar and a rise in the gold premium in London as a result of renewed fears that the dollar was to be devalued as a means of counteracting depression. In the beginning of July, these fears were dispelled and gave place to a rumour that negotiations for the stabilisation of the sterling-dollar exchange rate at the old parity of \$4.866 to the pound were being conducted at the same time as the negotiations for an Anglo-American Trade Agreement. In consequence, the dollar appreciated towards this rate; but this movement was temporarily stopped when the rumour was officially denied in the United States. At the same time, the Bank of England took the unusual step of making an official statement to the effect that "there was no truth whatever in the rumours that negotiations were taking place for a stabilisation of currencies or that the price of gold was to be altered". Even after these official statements, the appreciation of the dollar was renewed in the middle of July. The strength of the dollar was due to two fundamental causes: in the first place, there was a considerable movement of capital to the United States, both as a result of political uncertainties in Europe and also to take advantage of the renewed rise in the price of American securities; and, secondly, there was an abnormal demand for dollars to finance the continuing large excess of exports over imports in the United States.

THE FOREIGN EXCHANGES

In spite of the marked changes which have occurred in economic conditions, exchange rates remained remarkably stable during 1937 and the first months of 1938, except in a limited number of cases.¹ In China, in spite of the Far-Eastern war, the currency maintained its value until March 1938, when the Chinese Government was forced to introduce exchange restrictions and the value of the Chinese dollar was somewhat reduced. In the countries of South America, the fall in the demand for primary products caused a strain on the foreign exchange position during the latter half of 1937; and, in consequence, the value of currencies of a number of these countries

¹ In spite of the marked changes in the gold market, the dollar-sterling exchange rate remained very stable during 1937, as the following figures show:

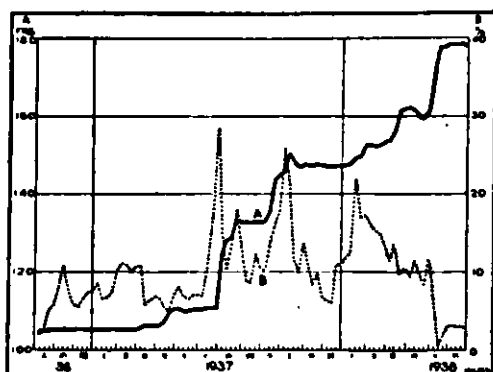
<i>Annual Percentage Range of Variation in the Dollar-Sterling Exchange Rate.</i>			
1934	1935	1936	1937
5.7	5.7	4.1	3.2

fell and severer measures of exchange control were imposed.¹ For the same reason, the balance of Indian trade has deteriorated

The Franc-Sterling Exchange Rate.

A Spot rate.

B Annual percentage discount on three-month forward francs.



rapidly since the middle of 1937, and there has been some strain on the rupee exchange.

But by far the most important movement of exchange rates was the continued depreciation of the French franc after its devaluation in October 1936 until the fixation of a lower limit of depreciation in May 1938. The graph opposite illustrates the history of this depreciation:²

At the end of September 1936, the franc was devaluated and, by the Law of October 1st, 1936, its gold value was to be maintained between 75% and 65.5% of its previous value. Until March 1937, the franc was stable at about 105 francs to the pound, as compared with 76 francs to the pound before the devaluation; but the heavy discount on forward francs indicated that the market was uncertain as to the maintenance of this rate. In March 1937, the franc depreciated to 108 francs to the pound; but confidence was then temporarily restored by the announcement of Government measures including the removal of restrictions on gold dealings, the issue of a large National Defence Loan with a foreign-exchange guarantee, and a reduction in extraordinary State expenditure. As after the 1936 devaluation, there was a temporary cessation of capital movements from France and some repatriation of funds. In April 1937, expectations of an appreciation of the gold value of the dollar led to a renewed outflow of French funds, and the franc fell to a rate of 112 francs to the pound, which marked the lower limit of devaluation set by the Law of October 1936.

In June 1937, there was a renewed flight of capital on a large scale, and the discount on forward francs rose to an

¹ The effect of the depression upon exchange control in South-American and other countries is discussed in greater detail in Chapter VIII.

² Cf. League of Nations, *Money and Banking, 1937/38*, Volume I, pages 27 ff.

unusually high level. By the middle of the month, the Exchange Stabilisation Fund, which had been credited with 10,000 million francs in gold out of the profit resulting from the revaluation of the gold reserves in October 1936, was exhausted, and a further 8,500 million francs had to be transferred from the Bank of France to the Fund. At the end of June, the limit set by the Law of October 1936 to the depreciation of the gold value of the franc was abolished; and the franc-sterling exchange rate fell immediately to 128 and later to 134 francs to the pound. In the latter part of July, the gold and foreign exchange reserves of the Bank of France were revalued at a price equivalent to the lower limit of devaluation set by the Law of October 1936 — although the franc had already depreciated below this level — and the resulting profit of about 7,000 million francs was paid to a fund established for the support of Government bonds.

During August 1937, the franc remained stable, but, in September and the first part of October, a renewed flight from the franc again raised the discount on forward francs and brought the spot rate to 150 francs to the pound. At this point, there was some considerable repatriation of funds into France, reinforced by the stock-market collapse in New York and fears of the possibility of a depreciation of the dollar; and the rate returned to a level of 147 francs to the pounds, which was maintained until the beginning of 1938. The pressure on the franc then increased again, the franc-sterling rate declined, and the discount on forward francs rose to a high level.

At the beginning of May 1938, measures were taken to set a definite lower limit to this depreciation. The exchange value of the franc was suddenly depreciated by about 10%, and a limit of 179 francs to the pound was set, beyond which the franc would not be allowed to depreciate, but above which it might appreciate. This measure gave an incentive for the repatriation of French funds, which occurred on a considerable scale immediately after the devaluation, and for the first time for many months the discount on forward francs disappeared. The choice of the limit for the franc-sterling rate allowed some margin for an internal expansionist policy. At the same time the Tripartite Monetary Agreement was continued with the full consent of the British and American authorities to the action taken by the French. In order to enable the French Exchange Equalisation Fund to buy up the repatriated gold, the Minister of Finance was authorised to advance additional sums to the Fund, and, at the same time, the fund established for the support of Government bonds was authorised to invest its resources in gold.

The peculiar exchange difficulties experienced by France were due to two closely connected factors — a flight of capital and an increasing excess of imports over exports. Rising internal costs and prices in France, due to the policies discussed in Chapters I and II of this *Survey*, led to a rapidly increasing deficit on account of foreign trade. This led in its turn to exchange difficulties and made further currency depreciation necessary. But the expectation that rising internal costs, through their adverse effect on the balance of trade, would make further depreciation necessary led to a speculative flight of capital from the franc, and this flight of capital, which was intensified by the prospect of continuing budget deficits and by a sense of political uncertainty, exerted an additional pressure on the franc and increased the necessity for further depreciation. These difficulties were avoided in Switzerland and the Netherlands, where there was only a moderate rise in internal costs and prices after devaluation; and, as has been observed above, there was a considerable inflow of capital into these two countries. In Switzerland and the Netherlands, as in France, there was some increase in the amount by which imports exceeded exports in 1937 as compared with the previous year; but both imports and exports rose considerably in value, and the percentage of imports which were covered by exports rose in both Switzerland and the Netherlands, while it deteriorated in France:

Value of Exports as a Percentage of Value of Imports.

	France	Switzerland	The Netherlands
1935	74	64	72
1936	61	70	73
1937	57	71	74

The graph on the next page enables a comparison to be made between the movements of French prices and wage-costs and the movements of prices and costs in other countries. The figures on the graph are all expressed in the common measure of gold values, so that international comparisons of price- and cost-movements are possible. The graph suggests that the devaluation of October 1936 restored the 1929 relationship between the wholesale prices of the old gold bloc and of the United Kingdom and the United States, and that, by the end of 1937, the relationship between French wholesale prices and British and American wholesale prices was more favourable to France than in 1929. It is in the figures for hourly wage-rates

Wholesale Prices, Cost of Living and Wage-rates in Gold.

(1929=100.)

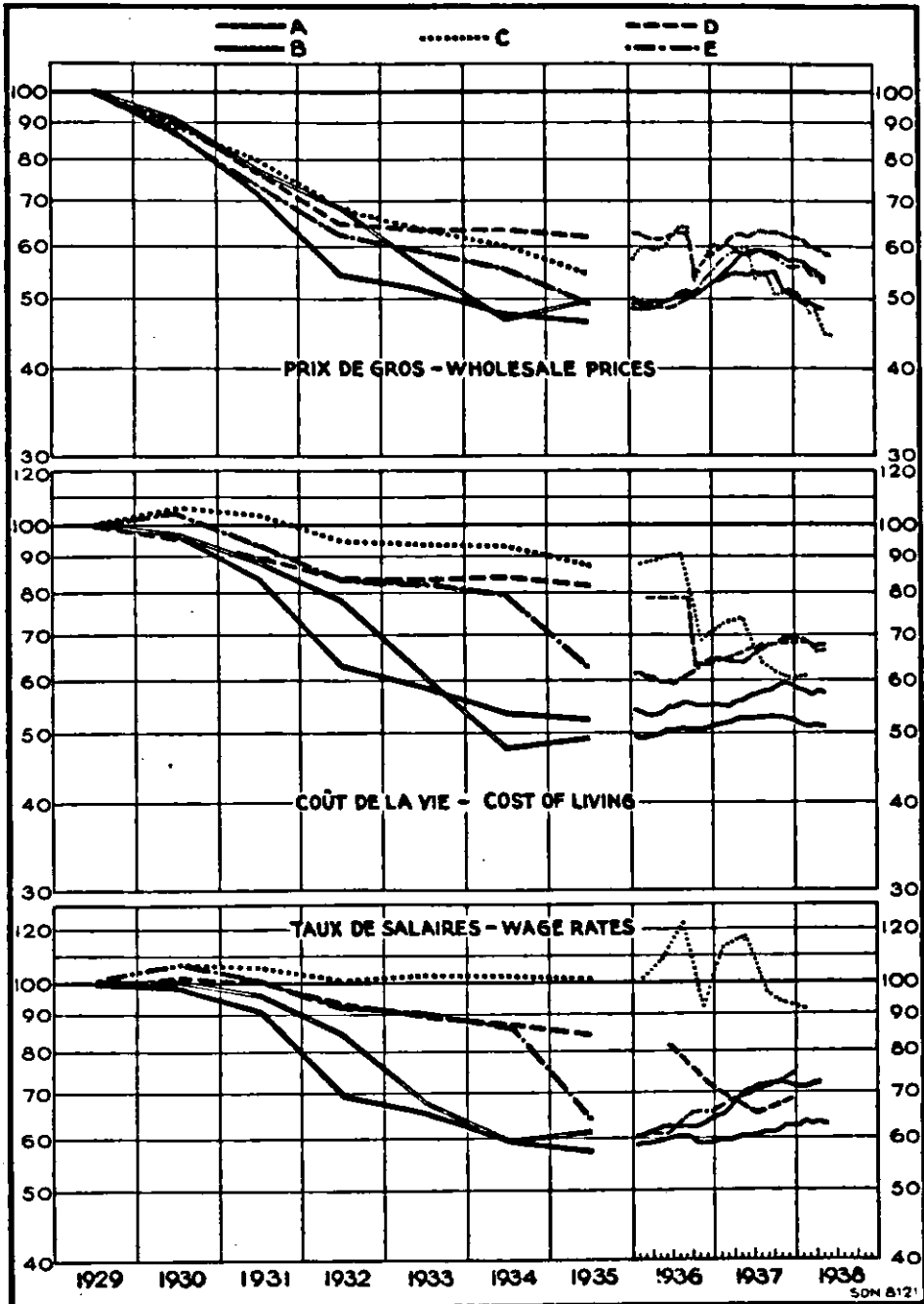
A United Kingdom.

B United States.

C France.

D Netherlands.

E Belgium.



expressed in gold that the unfavourable position of France is most marked. Even after the second devaluation of the French franc in July 1937, the rise in hourly wage-rates had been so great that the level of French wage-costs was some 30% less favourable in relation to American wage-costs, and some 40% less favourable in relation to British wage-costs, than in 1929. When every allowance has been made for the facts that the French franc was probably undervalued in 1929 and that the particular index of French wages¹ may exaggerate the recent rises in wage-rates for the country as a whole, the disparity remains marked. In this respect, the experience of the Netherlands differs markedly from that of France; for, as the graph shows, the index of the Netherlands gold wage-rates had fallen by the middle of 1937 to a level between those of the United States and the United Kingdom.

The graph also illustrates the foreign-exchange position of Belgium. It suggests that, after the devaluation of the Belgian franc in 1935, Belgian prices and wage-costs had been brought into line with prices and costs in other countries. But, towards the end of 1937, Belgium experienced certain foreign-exchange difficulties. The development of the depression in the United States caused a fall in Belgian exports, and, in consequence, the balance of trade grew more adverse at the end of 1937 and the beginning of 1938. At the same time, the repatriation of funds to France in the last quarter of 1937 and in May 1938 put a further strain on the Belgian franc and caused Belgium to lose gold. Immediately after the devaluation of the French franc in May 1938, this pressure became particularly severe; and, in addition to sales of Belgian francs on account of the repatriation of French money, there was some speculative flight from the Belgian currency. For some persons began to question the ability of Belgium to maintain the gold value of her currency in view both of the deepening depression in export markets for Belgian products and also of the increased competitive power of French producers after the further depreciation of May 1938. In fact, however, Belgium's external economic position depends upon the relation of her costs and prices to those of the United Kingdom rather than to those of France. It appears from the graph that, while Belgian and British wholesale prices measured in gold values have moved very closely together, the margins between Belgian and British cost of living and wage-rates have moved unfavourably to Belgium since the middle of 1936. Belgium is in many ways in a strong position internally to adopt a policy of cheap

¹ It is confined to workers in the Paris region.

money and credit expansion in order to mitigate the effects of the recession of trade activity, for she has plentiful bank reserves, and, in 1937, the Central Bank was given the right to practise, within certain limits, an "open market" policy of purchasing Government bonds in order to increase the supply of bank money on the market. But it appears that, in the absence of a marked recovery in the United States, the United Kingdom and other countries, such a policy might prove inconsistent with the maintenance of the gold value of the Belgian franc at the level rigidly fixed after the devaluation of 1935.

Chapter VIII

COMMERCIAL POLICY

In the last *Survey*, some net movement towards the liberalisation of trade was observed, in spite of many instances of increased restrictions. Since the summer of 1937, this conflict in commercial policy has continued; but again on balance some net movement towards the liberalisation of trade may be recorded. Previous chapters have outlined the way in which business recovery progressed up to the autumn of 1937. This recovery, combined with increased rearmament expenditure, led to increased demands for imports by the industrialised creditor countries, and thus to high export prices and favourable trade balances in the primary producing countries. When there is a strong demand for goods, and so for labour; when prices are high or rising; and when there is little strain on the balance of payments of debtor countries, the relaxation of tariffs, quotas, exchange controls and clearing methods can be carried through with least strain and least opposition; for apart from political or strategic considerations, the main objects of these restrictive measures are the prevention of unemployment by stimulating the demand for domestic goods at the expense of foreign products and protection against a strain on the balance of payments caused by excessive purchases of foreign money to finance capital exports or commodity imports. Since the American recession in the autumn of 1937, these favourable conditions have in many countries shown signs of passing. As has been shown in previous chapters, the demand for imports, first by the United States, and later by other industrialised countries, has been reduced; prices of primary products have fallen; and, in many countries, industrial employment has also been reduced. As will be seen later in this chapter, this change of conditions has already given rise to increased restrictions in some cases. The forces working for trade liberalisation will be seriously weakened unless measures are taken to preserve the prosperity and purchasing power of the main industrialised countries.

PROPOSALS FOR THE REMOVAL OF BARRIERS TO TRADE

Two notable reports have recently been published making proposals for the removal of trade barriers—the report of M. van Zeeland and the report of the League Committee for the Study of the Problem of Raw Materials. In April 1937, the British and French Governments requested M. van Zeeland to enquire into “the possibility of obtaining a general reduction of quotas and of other obstacles to international trade”. After visiting the United States of America and the European countries of greatest economic importance, M. van Zeeland, in January 1938, presented his report, the main proposals of which were along the same lines as the reports presented by the Economic Committee of the League of Nations in September 1937.

The improbability of obtaining extensive tariff reductions at present is frankly recognised; but M. van Zeeland proposes that countries should agree neither to raise existing duties nor to widen the scope of their tariffs, and gradually to reduce exceptionally heavy duties. In present conditions, he argues, the negotiation of reciprocal commercial agreements, based on the most-favoured-nation clause, such as the Anglo-American negotiations to which reference is made below, remains among the best methods for reducing tariff barriers. The most-favoured-nation clause binds each partner to a commercial treaty to grant to the other treatment which is at least as favourable as that granted to any third country; and thus the advantages of any tariff reductions negotiated in an agreement between two countries are automatically enjoyed by other countries to which most-favoured-nation rights have been granted. By this means, tariff reductions are generalised and tariff wars, provoked by discriminatory treatment, are avoided.¹ But, as M. van Zeeland recognises, this clause sometimes prevents the negotiation of reciprocal tariff reductions, since countries other than those negotiating the treaty are entitled to enjoy these reductions without making any concessions in return; and he therefore proposes that, while the clause should in principle remain general and unconditional, it should be suspended in the case of countries which employ inadmissible discrimination or which refuse to participate in a general attempt to reduce trade barriers, and that it should be drawn up in such a way as not to hinder the formation of regional pacts which lower tariff barriers and which are open to the adherence of all other countries on the same terms.

¹ Cf. Owen JONES, *Treaties of Commerce and Treaty-making Methods*, January 1938, for a full description of the advantages of most-favoured-nation clauses.

But quotas are a more formidable obstacle to trade than tariffs, since they fix rigidly and arbitrarily the quantity of goods which may be imported regardless of changes and developments in prices, productivity and other economic factors, which may call for adjustments in the channels of international trade. To avoid this rigidity in trading relations, M. van Zeeland recommends the gradual suppression of all quotas on industrial goods, and their replacement, if necessary, by ordinary import duties or by "tariff quotas".¹ He recognises that there are special difficulties in the way of suppressing agricultural quotas, but recommends an agreement that no new agricultural quotas should be imposed and that no existing quotas should be tightened up.

The expectation of sudden and violent changes in the rates of exchange between national currencies causes movements of "hot" money, in order to avoid a loss or to obtain a speculative gain in the exchange value of a particular money; and these movements of short-term funds in turn accentuate fluctuations in exchange rates, and so hinder international trade by increasing the uncertainties of exporters and importers. In M. van Zeeland's opinion, a return to the gold standard on an altered basis is the best solution of this problem; but, he observes, such a return must be the last step in the process of international collaboration, and must be postponed until international equilibrium has been achieved between the different national economic systems. In the meantime, he suggests, as a revision and extension of the tripartite currency agreement, that countries should agree to keep the exchange values of their currencies fixed within certain defined limits for periods of a year or of six months. Such an arrangement would remove most of the risks for current commercial operations without permanently preventing a country from altering the exchange value of its currency, if such a change became necessary in order to avoid undesirable internal adjustments of money prices, incomes and costs in view of changed external conditions.

M. van Zeeland recognises that prohibitions and restrictions on the transfer of funds from one currency to another are more serious monetary obstacles to trade than exchange fluctuations. Restrictions on the transfer of funds for long- or short-term loans may hinder trade by depriving it of essential credit facilities; but, above all, restrictions on the transfer of funds in payment for imported goods are the most serious obstacle to international trade. During the great depression of 1929-1933,

¹ Under a "tariff quota", a reduced duty is applied to a certain quantity of imports of a product, and a higher rate of duty is applied to all imports over and above this quota.

most debtor countries and a number of other countries adopted measures of exchange control in order to meet the strain on their balances of payments caused by the cessation of the flow of new foreign loans, the withdrawal of money already previously lent to them, the flight of domestic funds, and the diminishing demand for their exports. Measures of exchange control were, in the first instance, designed to prevent abnormal capital movement; but in many cases they were extended in such a way as to restrict purchases of foreign money for the finance of imported merchandise, as well as for the finance of capital exports. Such measures have ranged in severity from the unofficial ban on the issue of new foreign loans on the London capital market to the complete control of every foreign-exchange transaction in Germany.

These measures of exchange control have in turn led to "clearing" agreements. Exporters to countries imposing strict exchange control have found it difficult to receive payment for their goods; and in order to obtain payment for arrears and for further sales of merchandise, they have been forced to institute "clearing" agreements under which importers are obliged to pay the purchase price of the imported goods into a special account which is used to pay the exporters for the goods sold in the foreign country. Such agreements have meant that exporters of goods to a particular country receive payment only in so far as importers purchase goods of equivalent value from that same country. There has thus been a marked tendency for trade to be forced into unnatural channels so as to achieve a bilateral balance between each pair of "clearing" countries; and this removes the advantages of multilateral trade, which enables each country to sell its own special products in the markets in which they are most needed, and to obtain its own special requirements from the sources which can provide them most cheaply. In 1937, there were some 170 clearing agreements in operation.¹

M. van Zeeland recommends that the creditor countries should remove their restrictions on the movement of funds for the purpose of financing new foreign loans, and that the other countries should at least remove their exchange control over the purchase of foreign money for the finance of imports, even if their controls over capital movements are retained. But such controls could not be removed immediately without the previous attainment of certain necessary adjustments. For example, in spite of the fact that the substantial devaluation of every other important currency has raised the price of German goods

¹ Cf. *Der Welthandel im Clearingverkehr*, by Dr. Kurt SCHNEIDER.

to uneconomic levels compared with those of other countries, the exchange value of the mark has been maintained by direct and indirect subsidisation of exports and by exchange control, which prevents the purchase of foreign currencies for the export of capital and restricts such purchases for the finance of commodity imports. The removal of such exchange controls could not be carried through in an orderly manner without a previous devaluation of the currency to its equilibrium level, and without taking steps to prevent the sudden withdrawal of frozen credits from causing a quite unnecessary depreciation of the currency. M. van Zeeland argues that the abolition of exchange controls should proceed gradually; that it should be undertaken by each country only after the attainment of equilibrium between its national economy and international markets; that measures of control over capital movements may in many cases have to be retained; that frozen assets and arrears in clearing agreements should be consolidated into long-term loans; and that credits should be provided to ease the transition for countries removing their exchange restrictions. He suggests that, to provide these credits for the finance of trade, the different central banks might open credits in each other's favour through the Bank for International Settlements, which could carry out a multilateral clearing of the claims falling due in each currency; or the different States in co-operation might institute, under the administration of the Bank for International Settlements, a common fund the resources of which could be used to finance international trade during the period of readjustment.

In addition to a proposal that taxes, prohibitions and restrictions on the export of raw materials should be abolished, M. van Zeeland enumerates a number of suggestions to meet the problem of the unequal distribution of raw materials: the complete internationalisation of the regime of mandates; the application to all colonies of the open-door principle guaranteeing equality of economic treatment and opportunity in the colony to all persons irrespective of nationality; the creation of international privileged companies for the exploitation of colonial territories; the direct exchange of colonial raw materials in return for the execution of important public works by industrial States.

This problem of raw-material supplies had already been subjected to an exhaustive enquiry by the League Committee for the Study of the Problem of Raw Materials, which reported in September 1937. This report distinguishes between difficulties of supply, which include all direct obstacles placed in the way of the export and sale of raw materials by their producers,

and difficulties of payment, which include all difficulties experienced by the purchasing countries in obtaining the foreign currency required for the purchase of sufficient supplies. In the Committee's view, there can be no objection to certain restrictions on the export of these materials, such as duties raised for revenue purposes or for the development of the industry concerned, or prohibitions of export when home supplies are short. On the other hand, monopolies which enable producers to demand excessive prices, or prohibitions and taxes on export which have the same effect, or duties on export which discriminate against certain countries, are objectionable practices, but are rarely to be found. In fact, the regulation schemes¹ for certain commodities provide the only substantial restrictions on supply; and these schemes, in the Committee's opinion, are unobjectionable provided that the consumer's interests are adequately safeguarded, so that excessive prices are prevented.

In effect, the Committee concludes that difficulties of supply are unimportant, but that importing countries find real difficulty in obtaining foreign money to pay for their purchases. During the last crisis, debtor countries were driven to exchange controls in order to conserve the diminishing supplies of foreign money obtainable from loans and from the sale of exports. Their difficulties were accentuated by movements towards self-sufficiency in Central Europe, by the imposition of the United Kingdom tariff and by the tendency towards Empire preferences and Customs unions; for all of these things made it more difficult for the countries experiencing exchange difficulties to sell their goods abroad and so to obtain the requisite foreign money.² The proposals contained in M. van Zeeland's report, which have already been discussed at length, are very similar to the recommendations made by this Committee to meet the difficulties of payment for raw materials. Restrictions on payments should be relaxed by the abolition or modification of clearing systems and by the grant of financial support to the countries wishing to remove exchange controls. Barriers to trade might be reduced by the revision and re-adaptation of the 1927 Convention for the Abolition of Import and Export Restrictions and Prohibitions, and by bilateral or multi-lateral agreements to reduce tariffs. The Committee also drew

¹ These schemes are discussed later in this chapter.

² "The most effective way by which creditor countries could help in the solution of the monetary problems of the debtor countries would be by announcing their willingness to receive larger quantities of goods from such countries and by relaxing the regulations at present governing the use of funds representing the proceeds of sales." *Report of the Committee for the Study of the Problem of Raw Materials* (document A.27.1937.II.B), page 28.

attention to the proposal that the principle of the open door should be extended to other colonial territories, and recommended the relaxation of preferential tariffs in colonies, which might make it more difficult for certain countries to sell their exports and so to obtain foreign money for the purchase of their supplies of raw materials.

The Economic Committee of the League, in December 1937, in its report to the Council, suggested certain principles which should be observed to meet the difficulties of supply: international schemes regulating the supply of raw materials should be framed so as to afford effective representation of consumers' interests, and should be administered so as to provide adequate supplies and to prevent prices from rising to an excessive height; raw materials should not be subject to any export restrictions except in pursuance of such international regulation schemes, nor to any export taxes except duties at uniform rates which are imposed for revenue purposes or to improve the production, utilisation or marketing of the raw material; and foreigners should have the same opportunities as nationals for developing the natural resources of sovereign countries and of colonial territories.

Before these proposals for the liberalisation of trade can be carried out, many difficulties have to be overcome. Of these, the most serious are probably political; but there are at the same time substantial difficulties of an economic character. The economic system which has been built up in the autarkic States, and in particular in Germany, is made up of a number of interdependent measures, of which exchange control, import rationing and the official regulation of trade balances with individual countries in opposition to the principles of the most-favoured-nation system are important parts. It is true that, "in fact, we do not find on one side States devoted to a policy of complete autarky, and, on the other, States faithful to a strict observance of international free trade", but rather "that on the one hand all States . . . have had recourse to measures . . . inspired by the idea of national protection; while, on the other hand, they have all continued, and must continue, to submit to a system of international exchange".¹ Nevertheless, for countries which have not adopted exchange control and which have made little use of import quotas, the acceptance of these proposals would be comparatively simple; while in the case of countries practising exchange control, exchange clearings, and import rationing on an extensive scale, many co-ordinated

¹ Cf. *Report of M. van Zeeland.*

changes in policy would need to be carried out more or less simultaneously in a large number of spheres of economic activity.

Of equal importance is the slowing of the recovery and, in some countries, the threat of a new depression in trade and employment; for there is general agreement that an extensive liberalisation of trade becomes much more difficult in a depression, when export markets are contracting, when demand is falling off and prices are falling, and when employment and production are declining.¹ In this way, attempts to secure greater freedom of trade are intimately connected with the maintenance of buying power and the prevention of depressions.² Partly with this end in view, the Assembly of the League of Nations, at its meeting in September 1937, invited the Economic and Financial Organisation, in collaboration with the International Labour Office, to examine measures both for the prevention or mitigation of economic depressions and also for raising the standard of living; and committees have been set up for this purpose. The International Labour Organisation has also taken steps to encourage the planning and timing of public works expenditure in such a way as to mitigate economic depressions by offsetting fluctuations in private expenditure. At its session in June 1937, the International Labour Conference passed two recommendations on this subject—one on international co-operation in the provision of information concerning public works programmes, and the other on the principles and organisations necessary for the proper planning and financing of national public works; and by a resolution it instituted an international public works Committee, which held its first preparatory session in June 1938.³

¹ "If we place ourselves on the economic plane, it seems at first sight as if the most favourable moment for strictly economic collaboration were past. The general check in the recovery movement, and the special economic difficulties of certain great countries, are once again bringing back on to the programme schemes of national protection, which bear a remarkable likeness to the efforts of the crisis period." *Report of M. van Zeeland.*

"The Economic Committee has learned from experience that it is hopeless to attempt to conclude large-scale international agreements in regard to trade, finance or currency, so long as the prospective parties to such agreements have to take daily action to counteract a deepening depression . . . Trade concessions are possible only when the volume of trade is showing normal expansion." *Economic Committee's Report to the Council on the Work of its Forty-fifth Session, June 1937.*

² "It is an almost impossible task for Governments to adopt more liberal commercial policies during a depression . . . If, however, means can be found for maintaining demand at higher levels, the difficulties of Governments can much more easily be overcome. For this reason, it is important to associate the movement towards freer trade with a vigorous drive to secure increased demand for all forms of both capital and consumption goods through the raising of the standard of living." F. L. McDOUGALL, C.M.G.; *Annex on Economic Appeasement to Report to the Council by the Economic Committee at its Forty-sixth Session.*

"Unless we can work towards international control of the cyclical movement of trade, sooner or later we shall all be back in the gutter playing beggar-my-neighbour." D. H. ROBERTSON, "The Future of International Trade", *Economic Journal*, March 1938.

³ The Governments of Belgium, Brazil, Canada, China, Czechoslovakia, Egypt, Estonia, Finland, France, Great Britain, Greece, Hungary, Luxemburg, Mexico, the Netherlands, New Zealand, Norway, Panama, Poland, Spain, Sweden, Switzerland, the Union of South Africa, the United States of America, and Yugoslavia were represented at the session.

TARIFFS AND QUOTAS

In spite of a tendency towards the greater liberalisation of trade, there have been numerous increases in tariff and quota restrictions on imports in the period covered by this *Survey*. After the devaluation of the franc in September 1936, France lowered certain import duties and relaxed certain quota restrictions; but in view of the continued strain on the exchange value of the franc¹ and of the continuing unfavourable balance of trade,² after the further decline in the value of the franc in the summer of 1937, she raised the import duties on many products substantially to the previous level. Moreover, towards the end of 1937, numerous further increases were made for revenue purposes. In New Zealand, for the purpose of promoting domestic production, increased duties ranging from 5% to 35% were imposed on certain manufactured goods. At the end of 1937, Brazil imposed new duties on imports of wheat and flour. In July 1937, and again at the end of the year, Mexico effected large tariff increases; but in May 1938 it was announced that a Bill had been prepared recommending the reduction of these increased duties. Substantial increases were announced in the Egyptian duties on imports of cotton goods in April 1938, and in the Colombian textile import duties in May 1938.

The most striking example of increased restriction by means of import quotas is the enactment by Japan, in the autumn of 1937, of the Foreign Trade Control Law, the purpose of which was to restrict inessential imports in order to meet the exchange difficulties caused by the large expenditure on foreign goods made necessary by the war against China. The import of certain important commodities was restricted, while that of other commodities was prohibited entirely.³ There have been other instances of increased quota restrictions. In August 1937, Albania introduced a quota system. In numerous trade agreements negotiated in 1937, Italy insisted upon the bilateral balancing of new trade through control by import quotas. In South America, the fall in the prices offered for primary products, which began in the second quarter of 1937 and was intensified after the American recession in the second half of the year, caused some reversal from the tendency towards freer trading conditions, which had been marked in the period

¹ Cf. Chapter VII.

² Cf. Chapter VI.

³ Cf. Chapter I.

of high demand for primary products. Import duties were raised by Venezuela in August 1937, and by Chile in January 1938; in November 1937, import prohibitions were re-established in Bolivia, and the granting of new import licences was temporarily suspended in Colombia; measures have been taken in Uruguay, and have been proposed in Chile, to secure a stricter control over imports. In March and April 1938, the Belgian and French Governments restricted the quotas of coal imports. The effect of the recession in trade is also clearly illustrated by the experience of Roumania: with the removal of quota restrictions on a number of commodities in August 1937, about two-thirds of Roumania's total imports had become exempt from such restrictions, but quotas were re-introduced in March 1938. The control of imports was established in Venezuela in April, and was re-introduced in Ecuador in May 1938.

Movements in the opposite direction, towards the liberalisation of tariff and quota restrictions, were in large measure due to the high and rising demand for products which existed before the recession in trade in the autumn of 1937, and which induced countries to reduce tariffs in order to prevent a scarcity of commodities on the home market. Thus, in the course of 1937, import duties on iron and steel were reduced or suspended by a number of Governments, notably by the United Kingdom, Germany and Japan, whose demands, for armament purposes, were particularly high. But, as a consequence of the decline in business activity and in the demand for capital goods, these duties were restored in the United Kingdom in April and May 1938. Largely because of crop shortages, at least ten Governments in 1937 reduced or suspended duties on grain and other foodstuffs.¹ Italy and Poland both reduced duties on various machines and production goods in July 1937. Australia, in 1936, had adopted a policy of "trade diversion" to favour countries which were good customers of her products at the expense of those which were not so regarded; and the chief effect of this policy was to restrict the entry of Japanese and American goods by the use of import licences. The consequent dispute with Japan was settled by a trade agreement at the end of 1936. An automatic provision of American trade legislation deprived Australia of most-favoured-nation treatment in the American market until December 1937, when the Australian Government announced the abandonment of the trade-diversion policy and the replacement of import licences by duties. Restrictions were also relaxed by Turkey, who in

¹ Cf. Henry CHALMERS: "Foreign Tariffs and Commercial Policies during 1937", *Commerce Reports*, January 29th, 1938.

July 1937 removed all quotas, and reduced certain duties, on imports from countries with which she has a favourable balance of trade.

A number of reductions of duties have been effected by the negotiation of trade agreements, and there has been an increased tendency for these reductions to be extended to other countries by the operation of the most-favoured-nation clause. During 1937, a great number of international agreements were signed by the Latin-American republics, and lower duties on imports were granted in return for larger outlets for exports. Some of these negotiations were based on the unconditional most-favoured-nation principle, and others on the bilateral principle of allowing exclusive privileges to those countries which were the best customers of the negotiating State. During 1937, the number of such agreements based on the most-favoured-nation principle considerably exceeded the number of bilateral agreements.¹

Chile and Italy have both signed most-favoured-nation agreements with the United States of America, in spite of the fact that Italy in most of her negotiations has insisted on the bilateral balancing of trade.

In April 1938, a comprehensive Anglo-Irish agreement was reached, which put an end to the dispute over the payment of the Irish land annuities to Britain. The special duties which had been imposed by the British Government on Irish produce, in order to collect the annuities, and also the Irish retaliatory duties, were abolished. In addition, British duties on Irish agricultural products were reduced, and restrictions on the entry of British manufactured goods to the Irish market were relaxed. The agreement marked a further extension of the principle of Imperial preference. Irish agricultural products were to enjoy the full measure of preference granted to other dominions by the Ottawa agreements; and minimum margins of preference were guaranteed until 1940 for Irish eggs, poultry and certain dairy products as for similar products from other dominions. On the other hand, Ireland extends preferences to British goods, and guarantees free entry for British coal to the Irish market with a minimum duty of three shillings a ton on foreign coal.

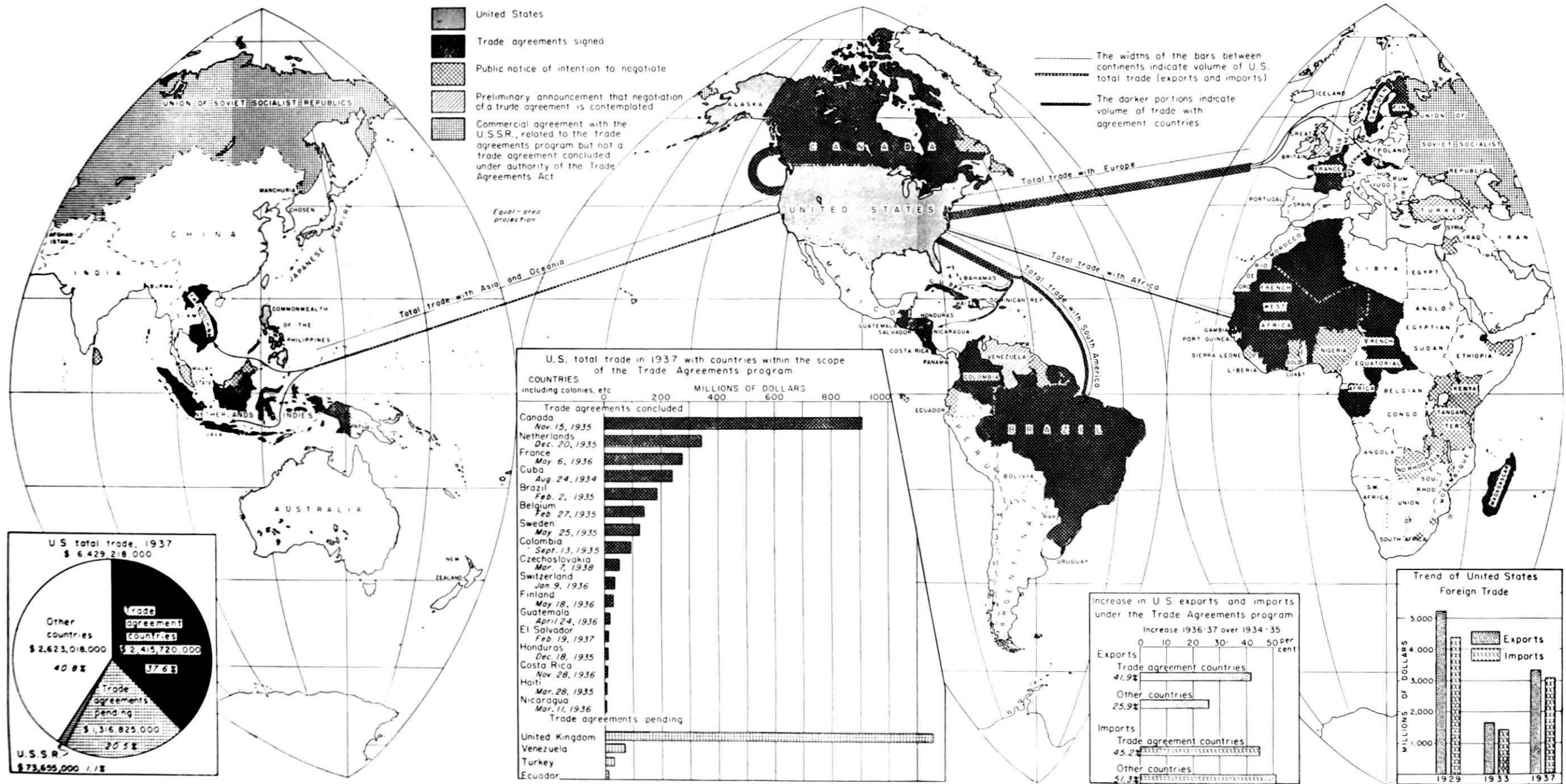
A more general attempt to liberalise trade was made by the "Oslo" group of Powers in the summer of 1937. A Convention was signed, by the terms of which the Netherlands and Belgium-Luxemburg agreed to abolish all quotas on goods for the other signatories of the Convention and to impose no new barriers on

¹ Cf. *Commercial Pan-American*, January 1938.

THE TRADE AGREEMENTS PROGRAMME OF THE UNITED STATES

COUNTRIES WITH WHICH TRADE AGREEMENTS HAVE BEEN CONCLUDED,
OR WITH WHICH NEGOTIATIONS ARE IN PROGRESS OR CONTEMPLATED

AS OF MAY 16, 1938



the group's trade, while Denmark, Norway, the Netherlands East Indies, Sweden and Finland agreed not to raise their tariffs or to impose new restrictions on the group's trade. Substantial tariff reductions could not be negotiated, since all other countries which had most-favoured-nation agreements with these countries could automatically have enjoyed the tariff reductions without granting similar concessions; and, in view of this and of the unfavourable trend of world trade, the agreement could not be prolonged when it expired in July 1938.

During recent years, the most important and most effective movement towards the removal of quotas and the reduction of tariffs has been the development of the American policy of negotiating reciprocal trade agreements based on the most-favoured-nation clause. Under the Trade Agreement Act, passed for three years in 1934 and later extended until 1940, the President of the United States is empowered to make agreements with foreign countries for mutual reductions in trade barriers without submitting these agreements to the Senate for ratification; but his powers are limited by a provision forbidding any decrease in duty of more than 50% on any transfer of goods between the dutiable and the free lists. Concessions made to any one country are generalised on the principle of equal treatment for all countries, except that the Act authorises exclusive concessions to Cuba. At the end of 1937, sixteen such agreements had been negotiated, and agreements were in different stages of negotiation with six other countries, including the United Kingdom. The countries with which trade agreements were in operation at the end of 1937 accounted for over a third of the total foreign trade of the United States and, with the conclusion of the new negotiations then announced, nearly 60% of the United States foreign trade would be with trade-agreement countries.¹

The trade agreements enabled American exports to trade-agreement countries to expand between 1934-35 and 1936-37 more quickly than her exports to other markets; but during the same period, American imports from trade-agreement countries have increased less rapidly than purchases from other countries.¹ According to an official explanation, two special factors have been mainly responsible for this: "the much increased volume of raw materials such as rubber, tin and wool, called for by the sharp expansion in the activity of American industries between the middle of 1936 and the fall of 1937; and

¹ Cf. the United States Department of State map, reproduced in the inset opposite this page.

the need for considerable importations of certain farm products, notably grain, fodder, and oil seeds, due to the shortage following the drought and short crops of 1936. It happens that the commodities for which our import demand during the past year or so was exceptionally large are obtainable mainly from countries with which no trade agreements have as yet been negotiated.”¹

In 1937, only two new trade agreements, relatively unimportant, came into effect; namely, those with Salvador and Costa Rica. But in March 1938 a trade agreement was concluded with Czechoslovakia. This agreement was of special interest because it encouraged the formation of a tariff group of Danubian countries. The United States recognised exceptions to the most-favoured-nation clause by the provision that preferences given by Czechoslovakia to Austria, Hungary, Yugoslavia and Roumania would not be regarded as violations of the clause.

But, most important of all, negotiations were opened for a trade agreement with the United Kingdom, Newfoundland and the British Colonial Empire. As the following figures for 1937 show, the United States and the United Kingdom are of great importance to each other, both as sources of supply for imports and as markets for exports:

Percentage of total United Kingdom exports sold to the United States . . .	7.1	Percentage of total United States exports sold to the United Kingdom	16.0
Percentage of total United Kingdom imports obtained from the United States	11.1	Percentage of total United States imports obtained from the United Kingdom	6.6

United Kingdom purchases of American produce are, however, much greater in value than American purchases from the United Kingdom; but this lack of balance in the trade is much less marked if both purchases by the United States from other parts of the British Empire and also United States payments for tourist expenditure and other invisible items are taken into account. The large excess of American sales of commodities to the United Kingdom, which is shown in the following table, is offset, first, by American payments to the United Kingdom for tourist expenditure, shipping services, financial services, interest and dividends, and secondly, by

¹ *Commerce Reports*, February 12th, 1938.

heavy American payments for purchases from the British Crown Colonies, especially of tin and rubber from British Malaya.

Anglo-American Balance of Payments, 1936.¹

A plus sign (+) indicates an excess of payments to the United States and a minus sign (—) an excess of payments by the United States.

	\$ (000,000's).	Merchandise and Invisibles *
United Kingdom	+ 240	+ 148
United Kingdom and Crown Colonies	+ 55	— 67
Total British Empire	+ 132	+ 13

* Excluding gold and silver and capital movements.

Any concessions granted in a reciprocal trade agreement by either of the two countries to the other are automatically enjoyed by the exporters of all other countries to which the two negotiating countries have already guaranteed most-favoured-nation treatment in previous agreements. It is true that for this very reason the two parties to a reciprocal trade agreement normally make concessions on the goods of which the other is the principal supplier, so that this automatic extension of the benefits to the exports of other nations is reduced to a minimum. But, in spite of this, concessions in an Anglo-American agreement will appreciably liberalise trade conditions for other countries. For both the United States² and the United Kingdom have insisted on the inclusion of the most-favoured-nation clause in their numerous commercial agreements; and, as the following figures show, their combined purchases make up a very significant part of the total purchases of internationally traded goods.

Percentage of World Imports (1937) bought by:

United States	11.0
United Kingdom	14.2
British Crown Colonies	3.8
British Dominions	10.2
Total	<u>39.2</u>

The previous trade agreements negotiated by the United States have obtained benefits mainly for American industrialists;

¹ *The Economist*, September 25th, 1937.

² At present, Germany is the only country which, by discriminating against United States goods, does not enjoy most-favoured-nation treatment by the United States.

and the agreement with the United Kingdom provides the opportunity of balancing this with concessions for the export of agricultural produce, such as wheat, timber, bacon and hams, apples and other fruit. But in order to grant concessions on such imports, the United Kingdom must either reduce the protection afforded to its own agriculture or else divert its purchases to the United States from other sources of supply, and, in particular, from the British dominions, which have enjoyed preferences for their sales of agricultural produce in the British market since the Ottawa agreements of 1932. In fact, as the following figures show, there has been a considerable diversion of United Kingdom trade since the Ottawa agreements:

*Percentage of United Kingdom Imports from,
and Exports to, the British Empire.*

	Imports	Exports
1931.	28.6	43.5
1937.	39.1	48.0

The negotiations for the Anglo-American trade agreements have therefore indirectly involved a reconsideration of the economic relations between the British dominions and the United Kingdom on the one hand, and the British dominions and the United States of America on the other. For example, it has been suggested¹ that an agreement could be reached on the following principles: the United States could offer tariff concessions on manufactured goods such as high-quality textiles, of which the United Kingdom is the chief supplier. In return, the United Kingdom could grant easier access to the British market for American agricultural produce such as wheat, timber, hams and fruit by reducing the preferences given to the dominions. Australia and Canada, who would be most affected by the increased American competition, could be compensated by a reduction in the preferences which they grant to British manufactured products. This would enable them to bargain for concessions in the markets of the United States and other countries in return for admitting other manufactured goods on terms more nearly equal to those granted to British manufacturers.

EXCHANGE CONTROL AND CLEARING AGREEMENTS

The progress of recovery of demand in export markets towards the end of 1936 and the first half of 1937 brought with it a marked reduction in the stringency of exchange controls

¹ *Anglo-American Trade Relations*, published by the Royal Institute of International Affairs, London.

and clearing agreements; and this tendency has continued at least during the first part of the period covered by this *Survey*. In February 1938, the embargo on foreign issues in the United Kingdom was relaxed. Prospective issuers of foreign loans were still asked to submit their plans to the Foreign Transactions Advisory Committee, but it was stated that the Committee would allow greater latitude to all applications except those on behalf of foreign Governments or public authorities. The main cause of this decision was stated to be the favourable foreign-exchange position, but it was pointed out at the same time that this decision was in harmony with M. van Zeeland's recommendation.¹ The embargo on foreign issues in the Netherlands has also been enforced less stringently, although it has not been completely suspended.

The more rigorous forms of exchange control have also been relaxed in a number of countries. Both Poland and Italy have relaxed the control of payments for the interest and service on *new* foreign loans, in order to encourage the flow of foreign capital into their economies. Portugal, which had already gradually attained almost complete exchange freedom, suspended control altogether in October 1937. Denmark has practised a system of controlling imports by requiring importers to obtain permits before making payments for certain classes of imported goods; but in December 1937 a large number of additional goods were placed on the free list of commodities for which no such permits are required. Since the second devaluation of her currency in October 1936, Czechoslovakia has relaxed exchange control for the restriction of imports, although restrictions have had to be maintained for tourists' expenditure, for exceptional capital transfers and for payments to countries which have also introduced exchange control. On the other hand, the majority of imports are still controlled by a system of import licences, although the list of commodities for which import permits are not required has been extended to cover about 50%, instead of only 20%, of the total value of imports.

In all countries exercising strict exchange control the foreign money obtained by exporters from the sale of their goods must be surrendered to the central bank or to some other authority at a fixed rate in exchange for the domestic currency. In many cases, however, only a proportion of the proceeds of exports must be surrendered in this way, and the remainder may be used more freely by exporters for other purposes. The stringency of exchange control may therefore be measured to some extent both by the proportion of the proceeds

¹ Cf. page 161.

of foreign sales which exporters are obliged to surrender, and also by the difference between the fixed rate of exchange at which these sums must be surrendered and the rate of exchange at which the remainder can be sold on the "free" market. In both these ways, exchange control has been relaxed in certain cases. For example, in Yugoslavia, exporters were bound until September 1935 to surrender 60% of the proceeds of their foreign sales, but this percentage was reduced by stages until it reached 25% in January 1938. The countries of South America, except Peru, Venezuela and Ecuador,¹ impose exchange restrictions, but only a proportion of the proceeds from the sale of exports must be surrendered at official rates. The remainder may be sold at different rates on a more or less "free" market. In these countries, therefore, the ratio of the official value of the currency to its value on the free market measures the stringency of the control by showing how far the official rate is out of line with the rate at which free exchanges would take place. The following figures show that the discrepancy between the official and "free" rates diminished up to

Ratio of Official to Free Exchange Values of the Currencies of Certain South-American Countries.

	Argentine	Bolivia	Brazil	Chile*	Colombia	Uruguay
1936: July	121	219	151	136	105	161
December	110	318	146	134	103	147
1937: July	108	148	132	134	102	137
December	114	.	.	129	105	149
1938: March	130	.	.	129	104	148

* Ratio of official to "export" value.

the middle of 1937. In the case of the Argentine and Uruguay, this came about by an appreciation of the free rate, due to the improved demand for the exports of these countries. In the case of Bolivia and Chile, the change was due to a depreciation of the official rate, which represented mainly an official recognition of, and adaptation to, changed conditions.

But it is also clear that the spread between the official and free rates of exchange has in nearly all cases increased again since the middle of 1937. This has in the main been due to a depreciation of the free rate in consequence of the lower

¹ Exchange control was abolished in Ecuador in July 1937, but certain restrictions upon exchange operations were re-established in May 1938.

prices offered for these countries' exports since the recession in business in the last half of 1937. In the Argentine, goods imported from countries with which the Argentine had a trade agreement are paid for with foreign exchange purchased at the official rate; but until January 1938, imports from countries with which there was no trade agreement and with which the Argentine's balance of trade was unfavourable had to be financed, not only at the more expensive "free" rate of exchange, but with the addition of a surcharge sufficient to bring the cost of the foreign exchange 20% above the "official" rate. In January 1938, this surcharge was reduced to 10%. In consequence, some increased demand for foreign money at the "free" rate was to be expected; and as at the same time the Argentine central bank ceased to support the "free" rate, this rate depreciated rapidly in relation to the official rate. In Brazil, special difficulties have been felt as a consequence of the fall in the price of her main export—coffee—owing to the termination of the valorisation scheme to which reference is made below. This led, not merely to an immediate depreciation in the "free" exchange rate, but also to the introduction of a new exchange-control system in December 1937. Under this system, all claims to foreign money obtained by the sale of exports must be sold to the Banco do Brasil, and the public administration is given preference in the purchase of foreign money over all private buyers, who have in addition to pay a 3% tax on the value of their purchases for the formation of an Exchange Equalisation Fund. In Colombia, exchange control was tightened in November 1937 by the restriction of the issue of import permits and by the introduction of Government control over the "free" market for foreign exchange.

In Japan, exchange restrictions were tightened in December 1937, mainly as a result of the strain imposed on the foreign exchange as a result of the war against China, although in this case also the deterioration in the markets for Japanese exports caused by the business recession may also have played an indirect part. In January 1937, purchases of foreign exchange for the finance of imports had been subjected to exchange control; and in December 1937 this control was intensified.

The system of making payments through clearing agreements began to be relaxed during the second half of 1936 and the first half of 1937. "Hardly any new exchange-clearing agreements have been concluded during that period, apart from the renewal of existing ones, and in several instances exchange-clearing agreements were replaced by other types of payment agreements. It appeared as though the revival of foreign trade and the improvement of the exchange position of some of the

financially weak countries might lead to the gradual liquidation of the system. Moreover, the two totalitarian States—Germany and Italy—adopted the policy of maintaining clearing agreements only with countries which had exchange restrictions. In relation to countries with free exchanges, they prefer to replace exchange clearings by payment agreements on the pattern of the Anglo-German Agreement of 1934.”¹ Under payment agreements of this kind, the country practising exchange control receives payment for its exports in free foreign currency, but in return it undertakes to allot a certain definite quota of foreign currency to its importers for use in the purchase of goods from the free-exchange country.

For example, France has suppressed clearing agreements and has instituted new payment agreements with a number of countries—in July 1937 with Germany, in October 1937 with Estonia, in December 1937 with Yugoslavia, in March 1938 with Roumania, and in April 1938 with Italy and Latvia. Estonia has replaced the clearing system by payment agreements in the case of Greece and Belgium. Hungary has replaced all her clearings by payment agreements. In certain cases in which clearing agreements have been renewed, the stringency of the restrictions involved has been relaxed. In March 1938, new Anglo-Italian trade and clearing agreements were signed. In the previous clearing agreement, Italian purchases of British goods had been restricted to 70% of the value of the sterling assets obtained by the sale of Italian exports to the United Kingdom, and the remaining 30% was used in the main to pay off arrears of old trading debts owing to United Kingdom creditors; but as these debts had practically all been paid off, it was possible to increase from 70% to 87% the proportion of the sterling proceeds of Italian exports which could be used for the purchase of British goods, and this permitted a corresponding increase in the Italian quotas for imports of United Kingdom products.

In July 1938, after the incorporation of Austria into Germany, the Anglo-German payment agreement of 1934 was revised. In place of the provision that Germany should apply to the purchase of goods from the United Kingdom at least 55% of the sterling proceeds of German exports to the United Kingdom, it was agreed that this proportion should vary on a sliding scale according to the value of Germany's exports to the United Kingdom. The scale was determined in such a way that, at the 1937 level of German exports to the United Kingdom, approximately 65% of the proceeds of these exports would be

¹ Article by Paul EINZIG in *The Banker*, October 1937.

pledged for German purchases in the United Kingdom. In the same month, the Swiss-German clearing agreement and the payment agreement between France and Germany were renewed after suitable adjustment to take account of the incorporation of Austria into Germany.

During the great depression, Germany, in particular, developed a system of clearing agreements with a number of countries which could find no alternative markets for their exports. These countries sold their exports in Germany; but because of the German exchange restrictions, they could obtain payment for these exports only by arranging that their importers of German goods should pay into a special clearing account the price of these imports, which could then be used to meet the sums owed by Germany to the country's exporters. In order to obtain arrears of payment from Germany by this means, a number of countries were forced to increase their purchases of German goods at the expense of other products, even if these other products were more suited to their requirements.¹ The recovery in the demand for goods in the world markets by countries with free exchanges has to some extent reduced the dependence of these countries on the German market. For example, Yugoslavia, instead of increasing her imports from Germany, adopted emergency measures to diminish her exports to Germany, and diverted these exports to countries with free exchanges. As a result of the operation of various clearing agreements, Turkey's foreign trade was directed into bilateral, and since 1934, into predominantly German channels. But in July 1937 a new agreement was signed with Germany under which Turkish sales to Germany were considerably reduced, and exports were directed again to free-exchange countries. The following figures clearly mark these changes in Turkey's trade channels:

Imports from Germany as percentage of total Turkish imports			Exports to Germany as percentage of total Turkish exports		
1929	1936	1937	1929	1936	1937
15.3	45.1	42.1	13.3	51.0	36.5

¹ The trade of countries in South-Eastern Europe and in South America was particularly affected by these measures. The extension of German trade with the former group of countries is illustrated by the tables on page 185; and the following figures show the recent changes in the trade channels of certain South-American countries:

	Imports from Germany as percentage of total im- ports of certain South- American countries			Exports to Germany as percentage of total ex- ports of certain South- American countries		
	1929	1936	1937	1929	1936	1937
Brazil	12.7	23.5	22.9	8.8	13.2	17.1
Chile	15.5	28.7	26.0	8.6	9.7	9.5
Colombia	14.4	22.3	16.3	2.1	16.6	15.7
Peru	10.0	19.4	19.7	6.1	12.1	13.7

This re-orientation of Turkey's trade towards the free-exchange countries was further stimulated by an agreement with the United Kingdom in May 1938 whereby the United Kingdom extends to the Turkish Government an Export Credits Guarantee of £10 million for the purchase of capital goods, together with an additional credit of £6 million for the purchase of war material from the United Kingdom.

In many ways, the recovery of world demand in 1936 and 1937 led to a relaxation of the control of trade through clearing agreements; and up to the present the business recession which started in the autumn of 1937 has not led to any important instances of renewed intensification of control by clearing agreements. But so long as Germany and Italy continue their policy of control over foreign trade and the foreign exchanges, it is difficult for the smaller countries of Central and South-Eastern Europe to abolish their policies of exchange control and clearings.

COMMODITY RESTRICTION SCHEMES

As mentioned earlier in this chapter, the Committee for the Study of the Problem of Raw Materials examined the effect on the supply of raw materials of international regulation schemes for different primary products.¹ It drew a distinction between those schemes which are operated under Government auspices, such as the schemes for rubber, tin, sugar and tea, and those which are of a private character, such as the schemes for copper, timber and nitrate. In the former case, the Committee was satisfied that governmental control combined with consumers' representation in the management of the schemes would ensure that consumers' as well as producers' interests were considered. In the case of purely private schemes, the Committee recommended that, in order to avoid excessive prices, consumers' representatives should be associated with the management of the schemes, that adequate publicity of the operations should be provided, that "public utility" principles of reasonableness and non-discrimination in charges might be

¹ In addition to international schemes regulating the supply of raw materials, there are a large number of international cartels or agreements regulating the sale of different industrial products. Mme. Laurence BALLANDE, in *Essai d'étude monographique et statistique sur les ententes économiques internationales*, enumerated eighty-six different Conventions of real economic significance which were in operation in 1936. The *Report on International Trade*, published by Political and Economic Planning, London, May 1937, also describes a large number of international cartels. In June 1938, the most important of these cartels — the International Steel Cartel — was renewed until the end of 1940 with the co-operation of the United States steel exporters. The existing agreement between the Cartel and the British Iron and Steel Federation was prolonged at the same time, and a more definite agreement with the American exporters was expected to be reached.

applied, and that the possibilities of Government participation in the management of these schemes should be seriously considered.

The operation of regulation schemes was much affected, first, by the rapid rate of recovery towards the end of 1936 and during the first half of 1937, and later by the business recession which started towards the end of 1937. In nearly all cases, restrictions were substantially relaxed during the first period of rapidly increasing demand. In the case of rubber, exports were restricted to 60% of the basic quotas in the first half of 1936, but they were raised to 65% for the second half of 1936, to 75% in March 1937, to 80% in June 1937, and to 90% in September 1937. In the case of tin, export quotas were raised from 100% in the first half of 1937 to 110% for the second half of that year; and in the case of copper, production quotas were raised by degrees from 75% in August 1936 to 105% in November 1936, while in January 1937 all restriction was temporarily suspended.

The recession in the United States and the subsequent slowing-down of recovery in many other countries towards the end of 1937 greatly reduced the demand for raw materials. Prices of raw materials fell rapidly, and stocks, which in many cases had been reduced to low levels, began to rise again.¹ The market for rubber, for example, is very dependent upon the demands of the American motor-car industry, and as much as 54% of the world output of rubber in 1937 was imported into the United States. The recession in the United States led to a reduction in the quotas for rubber from 90% to 70% for the first, to 60% for the second, and to 45% for the third quarter of 1938. In the case of tin, export quotas were reduced from 110% to 70% for the first, to 55% for the second, and to 45% for the third quarter of 1938. Moreover, in July 1938, a buffer pool was instituted, the main object of which is to reduce fluctuations in the price of tin by stocking and holding tin off the market when the price is unduly low and by selling from the pool when the price rises. Of the 45% tin quota permitted for the third quarter of 1938, 10% is to be contributed to the formation of the buffer pool, leaving an effective quota of only 35% for the market. The restriction of copper production, which had been abandoned in January 1937, was re-imposed at 105% of the basic quotas for December 1937, and this quota was reduced to 95% for the third quarter of 1938. The Conference of the European Timber Export Convention decided to cut export quotas for 1938 by a further 5% in January 1938, following a previous decision to cut these quotas by 10%. At

Cf. Chapters III and IV for figures of output, stocks and prices.

the Sugar Conference in May 1937, an agreement was formed by which export quotas were fixed for the sugar-exporting countries. The agreement allowed for a maximum cut of 5% in these quotas, and in April 1938 the International Sugar Council imposed this 5% reduction; and in July 1938 the exporting countries agreed to further voluntary reductions of exports, representing in all an additional reduction of 6.2% of the total export quotas for the year 1938-39.

In a time of falling demand, of reduced prices and of increasing stock, it is to be expected that output will be restricted, or else that the scheme of regulation will break down through the defection of individual producers who see the opportunity of increasing their own profits by expanding their production beyond their narrowly restricted quota. Up to the present, no important international regulation scheme has broken down; and in general, as described above, output has been severely restricted. In the case of tea, however, restrictions have actually been relaxed; for in November 1937 the International Tea Committee raised the export quotas for the year beginning April 1938 from 87½% to 92½% of the standard production of the restricting countries. Production by countries outside the restriction scheme is more important in the case of tea than in the case of most of the other restriction schemes: for example, in 1936, 19% of the world exports of tea came from countries outside the restriction scheme, whereas in the same year less than 3% of the world production of rubber came from outside producers. The action of the International Tea Committee has been ascribed to a desire to bring about a reduction in the price of tea, in order both to stimulate consumption and to deter countries outside the scheme from increasing their production.¹

On the other hand, Brazil's national scheme for the restriction of her coffee exports to maintain coffee prices was substantially modified in November 1937 after the failure of a Pan-American Coffee Conference to agree to a scheme of general restriction. The tax which was levied on coffee exports for the purpose of buying up surplus coffee and keeping it off the world market was reduced by 75%. As the following figures show, Brazil,

*Exports of Brazilian Coffee
as a Percentage of Total World Exports of Coffee.*

1929	1935	1936	1937
59.4	56.2	51.1	47.0

¹ *Rotterdamsche Bankvereniging. Quarterly Review No. 1, 1938.*

by attempting alone to maintain coffee prices, had been losing ground to competing producers, and the reduction in the export duty was intended to reduce the price of Brazilian coffee in order to meet the competition of foreign countries more effectively.

MOVEMENTS TOWARDS AUTARKY

Although there has recently been some trend towards the liberalisation of trade, nevertheless the movement towards greater self-sufficiency has continued in some countries. Some instances of diminished reliance upon imported products have already been given in this chapter. But the most important measures for self-sufficiency have, as in previous years, taken place in Italy and in Germany. In Italy, for example, the expansion of key industries under the self-sufficiency plan has continued; and with this end in view, the Government, in July 1937, granted exemption of import duties on materials and machinery not adequately produced in Italy, when these are needed for the development of the autarky plan. The Italian chemical guild has issued a four-year plan for the production of synthetic nitrogen; and plans are being formed to obtain potash and aluminium salts from Italian resources, and to promote the substitution of aluminium for copper. The Italian Government has decided upon a large-scale programme for the erection of oil refineries and hydrogenation works. It has also taken powers to aid the production of synthetic rubber by the imposition of import duties and the grant of subsidies.

But it is in Germany that the movement towards autarky has continued to be most marked. The following figures¹ illustrate the way in which Germany's dependence on imports has diminished:

Percentage of Value of Total German Supplies of Goods obtained from:

Years	Industry and Handicraft	Agriculture	Imports	All sources
1928.	56.3	20.3	23.4	100
1932.	46.7	30.7	22.6	100
1937.	62.7	21.6	15.7	100

In the case of cereals, Germany's dependence on foreign supplies increased in 1937, owing to the harvesting of poor crops, as the following figures show:

¹ *Weekly Report of the German Institute for Business Research, January 26th, 1938.*

German Crop Yields of Bread Cereals.

Metric tons (000's),		
1933	1936	1937
14,492	11,909	11,252

Net German Imports of Grain and Grain Products.

Metric tons (000's),	
1935/36	1936/37
297	2,060

In addition to the import of cereals, various other measures were taken to meet this shortage. In July 1937, a decree ordered the delivery by farmers of all harvested bread cereals after deduction of requirements for seed and for consumption on the farm; the use of bread cereals for forage was prohibited; an order to mix 6% of maize with rye was added to the existing order to mix 7% of maize with wheat in the preparation of bread, and in November 1937 potato meal instead of maize was ordered to be mixed with rye.¹

The four-year plan to make German industry as far as possible independent of foreign supplies has been further developed. The German Government has formed a special company—"The Hermann Goering Reich Ore Mining and Smelting Company"—the purpose of which is to recover and smelt German ore of poor grade; and it is hoped that this will enable Germany by 1940 to cover as much as a half, instead of the present proportion of approximately a sixth, of her iron and steel requirements from domestic sources. Special companies have been formed for the manufacture of petrol from coal, and it is hoped that in a short time the greater part of the country's petrol requirements will be covered by domestic production. The production of synthetic textiles is being developed; and the production of cellulose and paper from straw instead of from wood has been initiated. The production of synthetic rubber—Buna—is being extended by means of heavy duties on natural rubber, which protect the home market and also raise funds for the capital development of the synthetic product.

The incorporation of Austria into the German Reich has itself greatly affected the problem of German autarky. In the first place, Germany's foreign-exchange position has been eased. The publicly acknowledged reserves of gold and foreign

¹ *Reichs-Kredit-Gesellschaft*, "Germany's Economic Situation at the Turn of 1937/38."

exchange of the Austrian National Bank at the end of February 1938 amounted to 420 million schillings, which are worth RM 248.1 million gold.¹ In addition to these and to certain hidden reserves, Austria was owed balances of foreign money in clearing accounts of approximately 150 million schillings or RM. 88.6 million, after deduction of the clearing debt of approximately 50 million schillings due to her by Germany.² This acquisition of gold reserves and foreign balances is large in comparison with the published reserves of the Reichsbank of RM. 76 million, but it is of relatively small importance for the finance of imports, since Germany in 1937, for example, was importing goods at the rate of RM. 456 million a month. Austria has also a favourable balance of payments, and in the course of 1937 the published reserves of the National Bank increased by 61 million schillings (or RM. 36 million). This favourable balance of payments may, however, not be continued in the future on the same scale. Some commodities, such as timber, will now be sold by Austria to Germany instead of to countries from which additional reserves of foreign money could be obtained; and there may be a fall in the expenditure of foreign tourists, which is estimated to have brought to Austria about 150 million schillings (or RM. 88.6 million) of foreign money in 1937.³ Germany has, however, made an agreement with other countries which will have the effect of reducing her loss of free foreign money in consequence of a reduction of tourists' expenditure in Austria.⁴

Germany's foreign-exchange position is now also affected by the interest payable on the Austrian loans, which the German Government does not in principle recognise as obligations of the Reich. At the time of the negotiation of the revised Anglo-German payment agreement, discussed on page 176 above, a bilateral agreement was reached, whereby the German Government agreed to reimburse the British Government for any sums

¹ For the conversion of these Austrian gold reserves into gold Reichsmarks, the rate of exchange of 1.6929 schillings = 1 Reichsmark, corresponding to the gold contents of the schilling and Reichsmark, has been used. The mark is being substituted for the schilling in Austria at the rate of 1.5 schillings = 1 mark, which recognises the over-valuation of the mark at the official rate.

² Cf. Department of Overseas Trade, *Report on Economic and Commercial Conditions in Austria*, December 1937.

³ Cf. *London and Cambridge Economic Service*, March 23rd, 1938.

⁴ Under previous arrangements, the foreign money received from foreign tourists in Germany was devoted entirely to the repayment of debts to foreign creditors. Under the new agreement, 25 % of the foreign money received from tourists in Greater Germany will be at the free disposal of the German authorities, and the remaining 75 % will be devoted to the repayment of frozen debts. The diminution in the rate of repayment of frozen debts by 25 % of the proceeds of tourist expenditure in former Germany is counterbalanced by the fact that 75 % of tourist expenditure in Austria will also be used for this purpose in the future. If, however, tourist expenditure in Austria falls off considerably, only 25 % of this reduction will represent a loss of free exchange to Germany, while the remaining 75 % will represent a diminution in the rate of repayment of frozen debts.

paid by it in guarantee of the Austrian guaranteed loans and also to pay the interest service on the Austrian loans held by British nationals. At the same time, the rates of interest payable to British nationals on certain German and Austrian loans, including the Dawes and Young Loans, were reduced; but the interest so saved was allocated to the payment of sinking funds on these loans. At the time of writing (July 1938), the question of the Austrian debts has not yet been settled with the other creditor countries.

Austria can produce a number of commodities for supply to Germany which will aid the German policy of self-sufficiency. Most important among these are timber,¹ dairy products and iron ore. The following figures show the extent to which Austrian supplies of these commodities cover Germany's purchases from other foreign sources on the basis of 1937 figures; but

Commodities	Austria's exports to countries other than Germany	Germany's imports from countries other than Austria
Timber (thousands of tons)	1,237	2,273
Butter and cheese (thousands of quintals)	223	1,195
Iron ore (thousands of tons)	147	20,402

Austria's output of commodities such as these may be considerably increased as her economy is adjusted to the German four-year plan. On the other hand, Austria is even more dependent than Germany on imports for the majority of food-stuffs. She has to import proportions varying from 20% to 60% of her requirements of wheat, rye, oats and maize; and imports of cereals in the last three years have averaged almost half those of Germany, although her population was only about a tenth that of Germany.*

The incorporation of Austria into the German Reich will have important effects upon the trade of other countries, and in particular upon the trade of the countries of South and Eastern Europe. The following figures show the extent to which some of these countries have now become dependent upon Germany after the expansion of German trade in these markets since 1929 and in consequence of the incorporation of Austria into the Reich:

¹ The export of Austrian timber to countries other than Germany was forbidden immediately after the incorporation of Austria into the German Reich.

* Cf. *The Economist*, March 26th, 1938.

*Percentage of Total Exports of Certain Countries
to Germany and Austria.*

Countries	1929			1937		
	To Germany	To Austria	To Germany and Austria	To Germany	To Austria	To Germany and Austria
Bulgaria . . .	29.9	12.5	42.4	43.1	4.0	47.1
Czechoslovakia	19.4	15.0	34.4	13.7	7.3	21.0
Hungary . . .	11.7	30.4	42.1	24.8	16.9	41.7
Roumania . .	27.6	9.4	37.0	20.0	7.0	27.0
Turkey . . .	13.3	0.5	13.8	36.5	2.0	38.5
Yugoslavia . .	8.5	15.6	24.1	21.7	13.5	35.2

*Percentage of Total Imports of Certain Countries
from Germany and Austria.*

Countries	1929			1937		
	From Germany	From Austria	From Germany and Austria	From Germany	From Austria	From Germany and Austria
Bulgaria . . .	22.2	7.6	29.8	54.8	3.4	58.2
Czechoslovakia	25.0	7.8	32.8	15.5	4.2	19.7
Hungary . . .	20.0	13.2	33.2	26.2	18.0	44.2
Roumania . .	24.1	12.5	36.6	29.8	10.3	40.1
Turkey . . .	15.3	2.2	17.5	42.1	1.6	43.7
Yugoslavia . .	15.6	17.3	32.9	32.4	10.3	42.7

For certain commodities, this dependence is even more marked.¹ In some cases, there may be immediate changes in trade channels. For example, Austria's imports of coal and certain manufactured goods from Czechoslovakia may now be replaced by supplies from Germany. Moreover, a very large proportion of the trade of countries such as Czechoslovakia will now be conducted in transit over German territory. For all these reasons, these countries have become very dependent

¹ For example, in 1937 Germany took 43.4% of Yugoslavia's exports of fresh meat, 74% of Bulgaria's exports of eggs, 42.9% of Greece's exports of tobacco leaf, and 70.9% of Czechoslovakia's exports of wood.

upon Germany for their trade, while Germany remains dependent upon them to a much smaller extent.¹ They are therefore in relatively weak bargaining positions for the conclusion of new trade and clearing agreements with Germany, unless, in spite of the business recession, there is a marked accentuation in the trend towards the redirection of their trade to the free-exchange countries.²

¹ For example, while Greece sold 31.0% of her exports to Germany in 1937, these goods represented only 1.4% of Germany's total imports.

² In July 1938, the President of the Board of Trade stated that the British Government was "anxious to develop in every possible and practicable way trade in that part of the world [South-Eastern Europe], and will be glad to use any practicable methods to develop it."

Chapter IX

PRESENT ECONOMIC TRENDS

SUMMARY OF RECENT ECONOMIC EVENTS

In order to obtain a coherent picture of recent events, the first part of this chapter is devoted to a summary of the changes which have been discussed at length in the preceding chapters. The most marked feature of the period covered by this *Survey* is the change in trend from economic expansion to economic decline in a large number of countries. As is shown by the following figures, world prices, production, employment and trade have all fallen in recent months, after reaching a peak during 1937; and stocks of primary commodities have again started to increase.

World Indices by Quarters.

(1929 = 100.)

	1936		1937			1938
	IV	I	II	III	IV	I
Industrial production *	102.4	102.8	106.0	104.5	96.5	88.4
Number of workers in employ- ment *	96	95	101	104	101	96
Stocks of primary commodi- ties	101	92	80	95	111	108
Quantum of world trade . .	91	92	99	96	100	88
Gold prices of traded com- modities	45.0	46.5	48.0	48.5	48.0	47.5

* Excluding the U.S.S.R.

The first intimation of the decline in activity was the turning point in security prices, which started to fall in the United Kingdom as early as the end of 1936 and in the United States in the first quarter of 1937. Security prices are determined primarily by the prospect of future profits; and it appears that such prospects deteriorated early in 1937. In the United States, it was realised that business was not receiving new orders as quickly as had been expected and that companies' stocks of

raw materials and goods in process were rising quickly. Up to the end of the first quarter of 1937, commodity prices — in particular, raw-material prices — had been rising rapidly, largely as a result of speculative purchases; but, at the beginning of the second quarter of 1937, this commodity boom broke and raw-material prices fell rapidly as it was realised that the scarcity of raw-material supplies in relation to the demand had been much exaggerated.

These declines in security prices and in commodity prices were, however, only a prelude to a really serious decline in production and in business activity in general in the United States. The production of capital goods fell very sharply during the second half of 1937, whereas the production of consumption goods, which had started to fall as early as the second quarter of 1937, declined much more moderately and in the later months mainly as a result of reduced activity in the industries producing capital goods. In Chapter I, a number of reasons for this decline were discussed. The monetary measures taken early in the year to discourage further expansion, the growth of companies' stocks, and the rise in raw-material prices and in wage costs in the first half of the year — all these were factors unfavourable to investment in capital equipment. In particular, there were a number of reasons why expenditure on consumption goods, which had risen rapidly during 1936, ceased to rise in 1937. The payment of the veterans' bonus in 1936 had given a temporary stimulus to consumption, which came to an end in 1937; efforts were being made to reduce the budget deficit, and, under the social security scheme, taxes had recently been imposed on labour. These and similar measures, by preventing a further expansion of consumers' demand for finished goods, removed one of the main incentives for capital development, and so gave rise to the sharp contraction of activity in the industries producing capital goods.

This American depression exerted an adverse influence on activity in other countries. The rapid fall in prices on the stock exchange in the United States which occurred in the summer of 1937 was followed by similar reactions on the stock exchanges of other countries. For the prospect of a serious depression in an economy as important as that of the United States gave rise to the prospect of contracting world markets for exports and of contracting activity in other countries. Prospects of profit were unfavourably affected in these other countries, security prices fell, expenditure on capital development was restricted, and the general decline in business activity spread through the different economies. The American depression not only affected adversely the prospect of profit in other

countries in this way, but it soon exercised a directly depressing influence on the world commodity markets. United States imports are of great importance to other countries, and this is particularly true of the United States' purchases of raw materials which, in many cases, constitute a very large proportion of the total world demand. The industrial recession caused a severe contraction in American imports, and particularly in imports of raw materials, while American exports were maintained at high levels. These developments depressed commodity prices in the world markets, and imposed a severe pressure on countries which exported to the American market. It is to be expected that, in consequence of these developments, expenditure on imports by countries producing raw materials will be reduced after the normal time-lag as a result of the fall in their incomes from exports.

In these ways, the decline in business activity has spread to a number of other countries, although, as will be seen in a later section of this chapter, the spread has been very uneven. In those countries in which business activity has been adversely affected, the falling demand for goods and services has led to lower prices, reduced output and increased unemployment. In the case of industrial production, the reduced demand has caused a relatively large reduction in output and employment with a relatively small fall in price; but, in the case of the production of primary products, in spite of the operation of restriction schemes in certain markets, output has been reduced less rapidly than prices, and stocks have again been accumulated. As a result of these price movements, the terms of international trade have moved sharply to the disadvantage of those countries which export foodstuffs and raw materials in return for the import of industrial products.

Increased difficulties experienced in finding export markets, increased competition in domestic markets due to the fall in world prices, and the growth of unemployment have increased the reluctance of many countries to pursue a liberal commercial policy. As the evidence brought forward in the preceding chapter shows, the reduction in business activity has already hampered, and in some cases reversed, the incipient movement towards the liberalisation of trade relations through the relaxation of tariffs, quotas and exchange control. It has again become apparent that, in order to provide conditions suitable for the development of trade liberalisation, measures must be taken to preserve purchasing power and business activity in the important countries whose foreign exchange position is secure.

COMPARISON BETWEEN 1937 AND 1929

These recent changes in economic trend immediately raise the question whether the setback in activity is temporary or whether it marks the beginning of another depression which may last as long, even if it does not become so acute, as the great depression which followed 1929. As will be seen later in this chapter, there are a great many ways in which the economic conditions of 1937 differ from those of 1929; and, because of these important changes in economic structure and institutions, it is impossible to assume that the course of development now will follow the same lines as in previous trade cycles. Nevertheless, it is interesting to examine economic changes during 1937 and 1938 side by side with the changes which occurred in 1929 and 1930, in order to compare the magnitude of the changes in the two periods.

From the graph on page 191, it is clear that the fall in production and employment in the United States in recent months has been more rapid than in the period 1929/30. Wholesale prices have also fallen as rapidly as in the earlier period; but whereas, in 1929, wholesale prices had already been falling slightly for some time, in 1937, the fall in prices followed a period of rapid rise. Share prices have also fallen as rapidly in recent months as they did in the earlier period. In the last section of this chapter, reference will be made to the marked recovery which has taken place in security prices during June and July 1938 in the United States. At this point, it is interesting to note that, early in 1930, a considerable but temporary recovery occurred in share prices after the stock exchange collapse of the autumn of 1929; and it is important to determine whether the present stock exchange recovery in the United States is also of a temporary character, or whether, in the different economic conditions of 1938, it is the prelude to a lasting recovery of economic activity.

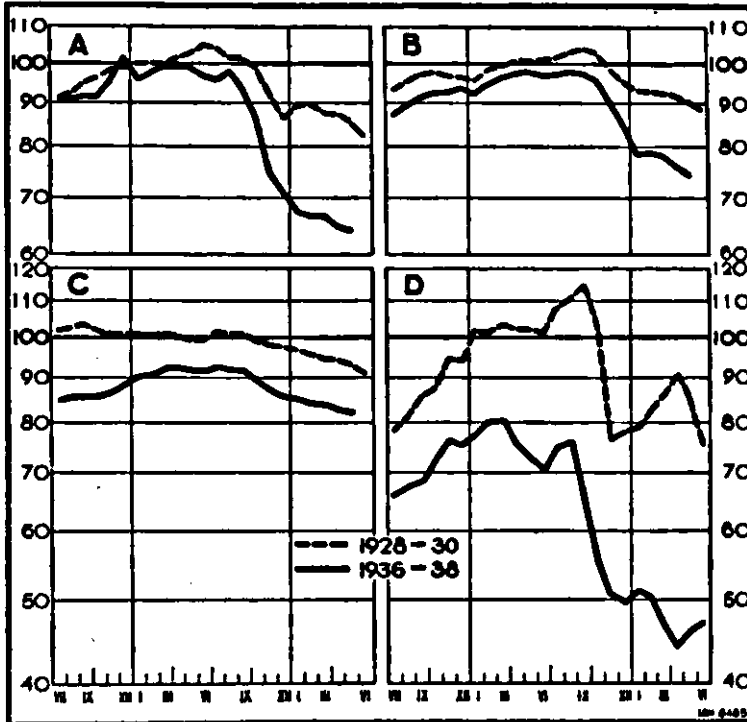
In the United Kingdom, production and employment in both periods have been more stable than in the United States. But there has already been some fall in activity in the United Kingdom; for, while the index of production in the first quarter of 1938 was still slightly above the level of the first quarter of 1937, the figures of employment have already fallen below the level of the previous year. Employment in the United Kingdom appears recently to have fallen less than in the corresponding months of 1930; and, while the movements of

*Business Conditions in the United States and
the United Kingdom.*

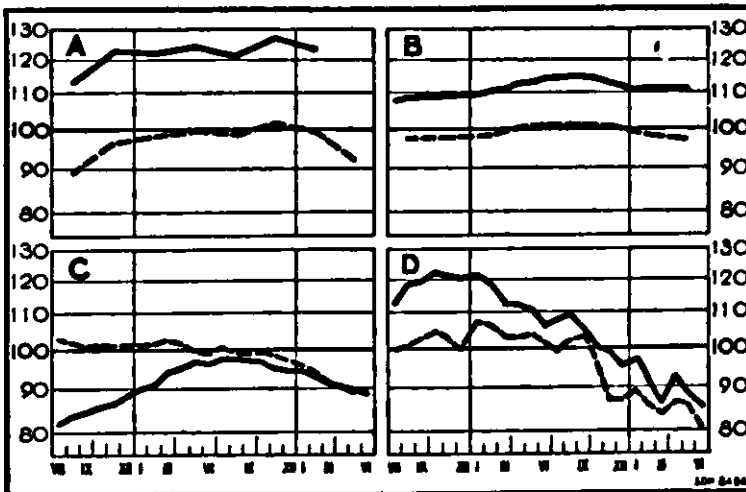
(1929 = 100.)

- A Industrial production.
- B Employment.
- C Wholesale prices.
- D Security prices.

United States.



United Kingdom.



production up to the second quarter of 1938 were very similar to those which occurred up to the second quarter of 1930, it is impossible to make a significant comparison between the two periods until the figures for the second quarter of 1938 are available.

Wholesale prices in the United Kingdom have not fallen recently so much as in 1929 and 1930; but, at the same time, the change in trend has been equally, if not more, marked, since wholesale prices were already falling before 1929, whereas, in 1937, the fall took the place of a rapid rise. Share prices have recently fallen more than in the earlier period; and, as in the United States, the recent fall in share prices started at an earlier date than in the period 1929 to 1930.

Between 1929 and 1937, there have been many changes in economic structure of the utmost importance, so that although both years appear to mark the peak of an upward movement of the trade cycle, it is dangerous to compare the two periods too closely. In 1929, nearly every country was on a freely operating gold standard. At that time, many important countries, including the United Kingdom, based their commercial policy on free trade principles; in many other countries, tariffs were at moderate levels; and industrial and agricultural import quotas were few and far between. Moreover, there were few, if any, instances of exchange control, and devices such as exchange clearings had not been developed so as to force trade into unnatural bilateral channels. There was also a relatively free flow of long-term capital from the countries in which capital was abundant to those in which it was scarce. In brief, there was, broadly speaking, a world economy, in which no country was isolated from the effects of fluctuations in activity in other countries.

At present, partly as a result of attempts to isolate individual economies from the effects of the last great depression, this comparatively liberal international economy has been overwhelmed by the abandonment of the gold standard and of free trade, by the raising of tariffs, by the imposition of quotas, exchange control and exchange clearings, and by the control of capital movements. In this way, nearly every country has to some extent reduced its dependence upon conditions in the rest of the world at the sacrifice of some of the advantages to be obtained from international specialisation, although some countries have gone much further in this direction than others.

But this growth of restrictions on international movements of goods and services is not the only important change in economic structure which has occurred since 1929. During

the same period, the attitude of Governments towards intervention in internal economic affairs has suffered an extreme change. In the Union of Soviet Socialist Republics, complete State control over economic affairs had already been instituted before 1929. In Germany, control over many aspects of internal economic life has been imposed since the post-1929 slump. Unemployment has been reduced to vanishing point by State activity in public works, in rearmament expenditure and the development of the armed forces, in industrial investment and the production of substitute raw materials under the four-year plan. To carry out these objects, prices and wages have been fixed, many raw materials have been rationed, labour has been made liable to conscription for work of interest to the State, and, in many other ways, industry has been subjected to increasing Government control. These measures have been combined with the control of external economic relations to form a co-ordinated policy of autarky, designed to make Germany as self-sufficient as possible. Similar but less far-reaching measures have been adopted in Italy. In Japan, as a result of the war against China, the Government has instituted control over imports and exports, capital investment, prices and raw materials; and, in the National General Mobilisation Law, passed in March 1938, extensive powers of control were granted to the Government over most of the main branches of economic life.

Even in countries such as France, the United States and the United Kingdom, in which internal economic conditions remain more or less liberal, Government economic intervention has developed considerably since 1929. The "Blum experiment" in France and the "New Deal" in the United States have involved the extension of Government control over prices, wages, hours of work, social services, monetary policy, the stock exchange and the new issue markets. In very many countries, the attitude of Governments towards monetary policy and unemployment problems has been completely reversed. In 1929, the main object of monetary policy was to preserve the gold value of each country's currency and to restrict credit whenever gold was flowing out of the country; and it was recognised that it was incompatible with this objective to adopt an expansive monetary policy in order to reduce unemployment if, at the same time, prices and money incomes were falling in other countries. But, at present, in the absence of the rigid exchange stability of the old gold standard, most countries would concentrate on monetary management to preserve economic activity rather than on the prevention of every external depreciation of the currency. In the United

Kingdom, for example, since the abandonment of the gold standard in 1931, monetary policy has been designed to preserve a regime of cheap money in the interests of internal economic conditions. As will be seen in a later section, this emphasis upon monetary management to counteract trade depression has been combined in a large number of countries with a greatly increased readiness to plan public works and to spend money upon their development as a means of counteracting unemployment.

Finally, mention must be made of certain other ways in which the position in 1937 differs fundamentally from that in 1929. All countries are now engaged in a heavy, and in many cases increasing, expenditure on rearmament, in comparison with which expenditure on armaments in 1929 was very moderate. At the same time, the sense of security, which depends largely upon the absence of international political tension and which greatly influences the spirit of business enterprise, was much greater in 1929 than at present. Moreover, international debts have been greatly reduced since 1929. The structure and reserve positions of the banking systems are much sounder now in most countries than they were before the last great depression. The absence of the gold standard has also permitted a better adjustment of exchange rates, so that there is probably at present less serious over- or under-valuation of the major currencies. Reference will be made to these conditions in later sections of this chapter.

DIVERGENT MOVEMENTS IN DIFFERENT COUNTRIES

As a result of the changes which have been discussed in the preceding section, there is little doubt that countries have gained a greater degree of independence in controlling their internal economic conditions at the sacrifice of the advantages of international specialisation. By means of the graph on page 64 of Chapter III, it has already been shown that there were much greater discrepancies in the rate of recovery in the years immediately preceding 1937 than in the years before 1929. The following table shows the large divergences that have occurred during the last year in the movements of industrial production in the different countries:

Recent Changes in Industrial Production.

Countries	Industrial production (1937 as % of 1929)	Percentage increase (+) or decrease (-) in industrial production between the first quarters of 1937 and 1938
United States of America	92.2	- 31.6
Belgium	93.6	- 20.2
Czechoslovakia	96.3	- 8.2
Canada	99.5	- 7.9
Netherlands	90.9	- 7.9
Roumania	131.7	- 7.6
France	82.8	- 7.1
Austria	106	- 4.1
Hungary	137.3	- 2.2
Denmark	134	- 1.5
United Kingdom	124.0	+ 1.1
Japan	170.8	+ 2.4
Norway	127.6	+ 2.7
Sweden	149	+ 3.3
Finland	149.2	+ 3.9
Chile	131.6	+ 4.5
Italy	99.6	+ 5.8
Germany	117.2	+ 10.2
Poland	85.3	+ 12.4
Estonia	138.7	+ 13.2
Bulgaria . . . . .	.	+ 14.9
Latvia	155.9	+ 22.8
Greece	151.2	...
U.S.S.R.	424.0	...

The table shows great disparities in the development of production in the different countries between 1929 and 1937. A number of countries, including the United States, Italy, France and other countries of the old gold bloc, had failed to regain the 1929 level. On the other hand, certain countries, which were already highly industrialised in 1929 — such as Germany, the United Kingdom and Sweden — had already surpassed the 1929 level of production.¹ Industrial production in a number of other countries, of which Japan and the Union of Soviet Socialist Republics are the chief examples, greatly exceeded the 1929 level as a result of rapid industrialisation. At the same time, there have been great disparities in the

¹ In making these comparisons, it must be remembered that the 1929 level was itself much higher in France and the United States, for example, than in the United Kingdom.

development of industrial production between the first quarters of 1937 and of 1938, ranging from a 32% fall in production in the United States to a 23% rise in production in Latvia. The decline has been much more serious in the United States than in any other country except Belgium, which is largely dependent upon foreign trade and has been particularly affected by the American recession.

From the evidence given in preceding chapters of this *Survey*, it is clear that there have been great divergences in economic development in other branches of economic activity as well as in production. In the United States, there has been a rapid and serious decline since the summer of 1937 in nearly all branches of economic life. In the United Kingdom, the period of economic expansion has, at least temporarily, come to an end; and the volume of employment has shown a moderate decline. In France, recovery from the post-1929 depression was delayed, first as a result of the deflationary policy made necessary by adherence to the old gold parity when other countries allowed their currency to depreciate, and later as a result of the internal economic difficulties discussed in Chapter I; and recovery in the French economy appears now to have been delayed once again as a result of the general decline of activity in other countries. Improvement in the other countries of the old gold bloc was also delayed; but there was a substantial recovery in Belgium after the devaluation of 1935 and in Switzerland and the Netherlands after the devaluations in 1936. In these countries, however, and in Belgium in particular, there has been a setback since the autumn of 1937.

There are, on the other hand, a number of countries which have experienced little recession since the summer of 1937. In Sweden, for example, in spite of the importance of export trade, industrial production and employment remain on a high level after a very slight decline since the middle of 1937; and, in the very different economies of Norway and Denmark, there has been little, if any, recession. In Germany and Italy, production and employment have continued to expand; but, in both countries, the value of exports has shown some decline since the beginning of the American recession, and there has also been a serious fall in security prices during 1938. In Japan also, production has not declined; but the expansion appears to have slackened or to have come to an end, and the recession in world markets has caused a fall in her export trade.¹

¹ This has increased the difficulties experienced in the finance of imports. In July 1938, a Foreign Exchange Fund Account was set up; and this Fund, which was financed with 300 million yen of the 801 million yen of gold which remained with the Bank of Japan, is to be used to pay for imports of raw materials required for the export trade.

REARMAMENT,
PUBLIC WORKS AND MONETARY EXPANSION

Among the most important changes which differentiate present economic conditions from the months immediately following the decline of 1929 are the growing volume of Government expenditure on rearmament and the active policy now adopted in many States to promote recovery by means of monetary expansion and increased expenditure on capital development. In 1929, expenditure on armaments was on a comparatively moderate scale; and, at that time, the need for each country to determine internal policy in such a way as to preserve the fixed gold value of the national currency, together with the relative unwillingness of Governments to intervene in economic affairs, prevented any large-scale policies of monetary or economic expansion from being promptly adopted. At present, as will be shown in this section, all Governments are spending considerable sums on rearmament, and there is a very much greater readiness to undertake large schemes of monetary expansion and of capital development to offset a decline in business activity.

The table and notes on pages 198 and 199 show how greatly rearmament expenditure has increased since 1929, and how rapidly it has risen in the most recent years. The figures in the table itself show only the figures of armament expenditure from the national budgets. In 1929, these figures represented practically the whole of national expenditure on armaments; but, as the notes show, with the rapid expansion of armament expenditure in recent years, a large amount of such expenditure has been financed by borrowing through extra-budgetary funds. In Japan, the war against China has recently entailed a large additional expenditure; and whereas, for the year 1929/30, the budget expenditure on national defence was only 495 million yen, for 1938/39 special war credits of 4,850 million yen have been voted in addition to estimated budgetary expenditure on national defence of 1,247 million yen. In order to obtain an idea of the importance of such expenditures, these figures may be compared with the last estimate of the Japanese national income of 13,109 million yen for 1936.¹

In Italy, as a result of the Ethiopian war and of the policy of rearmament, large emergency expenditures have recently been made in addition to the budgetary expenditures shown in the table on page 198. According to a statement of the

¹ Cf. the table on page 136 of Chapter VI.

Budget Expenditure on National Defence.

National currencies (000,000's).

Financial year: A = calendar year; B = 1.IV/31.III; C = 1.V/30.IV;
D = 1.VI/31.V; E = 1.VII/30.VI; F = 1.IX/31.VIII.

Figures in ordinary type = Closed accounts. Figures in italics = Estimates.

Country	Period covered by financial year	Currency	1929 1929/30	1936 1936/37	1937 1937/38	1938 1938/39
<i>America:</i>						
Argentina	A	Paper peso	112	210	162	...
Bolivia	A	Boliviano	.	42	60	87
Brazil	A	Paper milreis	445	788	1,000	1,039
Canada	B	Dollar	21	20	35	...
Chile	A	Peso	237	373	419	430
Ecuador	A	Sucre	9	24	20	...
Paraguay	F	Paper peso	63	281	...	...
Peru	A	Sol	.	37	33	36
United States	E	Dollar	703	967	993	...
Uruguay	1	Peso	9	10	16	...
<i>Asia:</i>						
China	E	Yuan \$	210	322	393	...
India	B	Rupee	504	423	441	423
Japan	B	Yen	495	1,078	1,411	1,247
Siam	B	Baht	21	24	27	...
<i>Europe:</i>						
Austria	A	Schilling	100	165	210	220
Belgium	A	Franc	981	1,384	1,442	1,569
Bulgaria	*	Lev	1,078	1,172*	1,271	1,361
Czechoslovakia	A	Koruna	1,793	3,761	1,793	4,449
Denmark	B	Krone	47	44	44	61
Estonia	B	Kroon	18	20	20	21
Finland	A	Markka	640	912	924	1,239
France	A	Franc	10,969	8,277	9,523	11,064
Germany	B	Reichsmark	691	.	.	...
Greece	B	Drachma	2,211	4,627	5,096	...
Hungary	E	Pengö	114	108	128	155
Italy	E	Lira	4,960	4,667	5,953	...
Netherlands	A	Gulden	75	92	97	131
Norway	E	Krone	38	45	48	49
Poland	B	Zloty	866	768*	768	800
Portugal	*	Escudo	415*	585*	626	662
Roumania	*	Leu	7,536	8,341	9,615	10,750*
Sweden	E	Krona	138	158	186	277
Switzerland	A	Franc	85	95	104	121
Turkey	D	£T	69	70*	77	102
U.S.S.R.	*	Rouble	1,150	14,816	20,102	...
United Kingdom	B	£	99	172	262	327
Yugoslavia	B	Dinar	2,309	2,309	2,459	...
<i>Oceania:</i>						
Australia	E	£A.	4	9	8	...
New Zealand	B	£N.Z.	0.9	1.2	1.6	...

* Uruguay: 1929/30: Financial year 1.VII/30.VI; 1936, 1937, 1938: calendar year.

* Bulgaria: 1929/30: 1.IV/31.III; 1936, 1937, 1938: calendar year.

* Portugal: 1929/30, the financial year covers the period from July 1st to June 30th. As from January 1st, 1936, it coincides with the calendar year.

* Roumania: 1929: calendar year; 1936, 1937, 1938: financial year 1.IV/31.III.

* U.S.S.R.: 1929/30: financial year 1.X/30.IX; since calendar year.

* Provisional.

* Expenditure on investments and the National Aviation Fund, included up to 1937/38, is not comprised in the figure for 1938/39.

SOURCE: League of Nations, *Armaments Year-Book*, 1933.

NOTES

Chile: In addition to the ordinary budget, there are certain appropriations for the army and the navy covered by the proceeds of loans (49 million pesos in 1937, 119 million pesos in 1938).

Peru: Extraordinary expenditure on war, the marine and aviation amounted to 15 and 45 million soles in 1935 and 1936 respectively.

Japan: The figures given above refer to the defence expenditure in the general account only. No details regarding the special accounts are available. In addition, the figures above do not include the special extraordinary credits occasioned by the China campaign, amounting for 1937/38 to 2,560 million yen and for 1938/39 to 4,850 million yen.

Czechoslovakia: In 1937, actual expenditure amounted to 4,855 million crowns.

Denmark: The Law of April 12th, 1938, authorised the floating of a long-term internal loan of 50 million kroner, the proceeds of which are to be utilised to cover supplementary expenditure in 1938/39 on reserve stocks of metals, coal, grain, fertilisers and war material.

Estonia: By the Law of April 11th, 1938, a National Defence Fund was created for carrying out new construction and for the purchase of war material.

Finland: By the Law of May 20th, 1938, a programme of 2,710 million markkaa of capital expenditure on defence equipment and new military constructions was adopted, which is to be carried out within the period of seven years. The estimated expenditure of 1938 includes the first *tranche* of 460 million markkaa on account of this programme.

France: In addition to the ordinary budget, there are certain defence expenditures covered by loans, more particularly:

(1) Special Treasury account called *Organisation défensive des frontières* (Law of July 20th, 1931), amounting to 2,528 million francs;

(2) Special Treasury account entitled *Programme de travaux intéressant la défense nationale* (Laws of July 6th, 1934, December 25th and 31st, 1935), amounting to 5,120 million francs;

(3) Special Treasury account called *Installations et matériel d'armement* (Laws of January 4th, 1935, and December 31st, 1935), amounting to 1,301 million francs;

(4) Special fund entitled *Fonds d'armement, d'outillage et d'avances sur travaux* (Finance Law of 1936) whose effective total expenditure relating to National Defence amounts to 6,748 million francs;

(5) Special credits opened by the Finance Laws for 1937 and 1938 and by the Decree of May 2nd, 1938, on account of capital investments, amounting to 9,501 million francs in 1937 and to 19,992 million francs in 1938. A *Caisse autonome de la Défense Nationale* was created by the Law of March 5th, 1938, for two years beginning on January 1st, 1938, to meet the Capital Investment Account expenditure on national defence. The *Caisse* is authorised to have grants advanced to it by the Treasury and to borrow or to issue loans to meet the expenditure charged to it.

Germany: No budget has been published since 1934.

Greece: In addition to the ordinary budget, an autonomous Defence Fund has been formed since 1930/31, whose expenditure was estimated for 1937/38 at 1,381 million drachmæ.

Hungary: In June 1938, a five-year plan was adopted providing for an expenditure of 1,000 million pengő for rearmament and public works.

Italy: According to a statement of the Finance Minister before the Chamber of Deputies on May 18th, 1938, the extraordinary expenditure incurred by the Government during the last three fiscal years and in the first nine months of the current year — up to the end of March 1938 — to meet the cost of the Abyssinian war, the rearmament programme and the initial outlay for developing the Empire, totalled 36,000 million lire.

Netherlands: In order to finance rearmament, the Government is contemplating the creation of a national defence fund into which all receipts resulting from tax increases are to be paid.

Norway: In March 1938, a loan of 52 million kroner was issued, the proceeds of which are to be set apart as a fund for strengthening the defence of the neutrality and the supplies of the country.

Roumania: A Defence Loan, amounting to 2.35 milliard lei, was issued in June 1938.

Sweden: A Bill passed in May 1938 provided for an additional expenditure of 70 million kronor for national defence.

Switzerland: In addition to the budget figures, extraordinary defence expenditure amounted to 1.4 million francs in 1936 and to 48.7 million in 1937.

Turkey: An agreement, concluded in May, provided for a British Government loan of £6,000,000 to Turkey, to finance Turkish purchases in the United Kingdom of material necessary for Turkey's defence.

United Kingdom: By the Defence Loans Act of March 19th, 1937, the Treasury is authorised to expend on the defence services, during the five financial years 1937/38 to 1941/42, additional amounts aggregating £400 million, to be met from borrowed funds. Estimated expenditure for 1937/38 and 1938/39 amounts to £80 million and £90 million respectively.

Australia: The defence programme will amount, in the next three years to £43 million. For 1938/39, the provision is £11 million.

Italian Minister of Finance, the following are the totals of these emergency expenditures:

Lire (000,000's).		
1934/35	1935/36	1936/37
975	11,137	17,519

In Germany, no budget figures have been issued since 1934. In France, as the notes to the table show, a large part of the national expenditure on rearmament is now financed from extra-budgetary funds. In April 1938, M. Blum explained that total expenditure on armaments for the current year would amount to 27,793 million francs, or 46% of the total fiscal receipts. According to the proposals of March 1937, it is intended that some £400 million should be spent from loans in the United Kingdom on rearmament in a period of five years, in addition to the increasing sums allocated to national defence in the budget.¹ It has been estimated² that the proportions of national income devoted to expenditure on armaments has risen between 1928 and the present time from 3% to 7% in the United Kingdom, from 4.5% to approximately 10% in France, and from 1% to 1.5% in the United States of America.

A glance at the table and notes on pages 198 and 199 is sufficient to show that the rise in armaments expenditure has taken place in small countries as well as great, and in all parts of the world — Europe, North America, South America, Asia and Oceania. According to the German Institute for Business Research,³ the value of world trade in armaments — reckoned in national currencies — in 1937 was 28% greater than in 1929, whereas the value of total world trade reckoned in the same way was 23% lower than in 1929. According to the same authority, world expenditure on armaments had risen from 150% of the pre-war level in 1929 to between 375% and 425% of the pre-war level in 1937; and this authority estimates that, in 1938, the demand for commodities arising directly from the world's expenditure on rearmament will reach a figure as great as the combined exports of all European countries in 1936.

Expenditure by Governments on this scale may be expected to sustain economic activity at least during the first period of rearmament, when private firms have to extend their capital equipment to meet these increased Government orders. But,

¹ In March 1938, it was officially announced that the total expenditure on arms would almost certainly exceed the sum of £1,500 million at which it had been originally fixed for the five-year period.

² Cf. *Wochenbericht des Instituts für Konjunkturforschung*, Berlin, June 22nd, 1938.

nevertheless, the stimulating effects of expenditure on armaments must not be exaggerated. As has been seen above, expenditure on armaments has risen in recent years from 3% to 7% of the national income in the United Kingdom, and from 4.5% to 10% of the national income in France. While these are large increases, it is very doubtful whether expenditures on this scale could in themselves completely offset a serious fall in business activity. It must also be remembered that a large part of the increased expenditure on armaments has been financed by increased taxation; and in so far as the payment of these higher taxes reduces expenditure on consumption goods, or discourages expenditure by private business on capital development, increased rearmament expenditure does not represent any net addition to the demand for goods and services. When men and capital are employed in the production of goods such as armaments, which cannot be consumed, the possibilities of consumption and the standard of living are reduced, unless the national income is stimulated by increased expenditure on armaments to a greater extent than it would be by any alternative means. At the same time, rearmament accompanies, and is accompanied by, political tension, which breeds a sense of insecurity and is therefore inimicable to private economic development. But, in spite of these considerations, it seems probable that the continuation of heavy rearmament expenditure will at least prevent a decline in business activity from proceeding as far as it might otherwise have done.

As has already been seen in Chapter V, the increased value of monetary reserves in a great many countries has ensured plentiful supplies of money and credit. This, combined with the absence of fixed gold values of most national currencies, differentiates the monetary situation from that of 1929, and has enabled many countries already to take measures to increase the supply of money and to ease credit conditions still further as one method of counteracting the recent recession. Part of Chapter V has been devoted to a discussion of the many measures of this kind which have been taken in the United States, and which include the reduction of discount rates and the open-market purchase of securities by the Federal Reserve Banks, the reduction of legal reserve requirements for the member banks, the desterilisation of the gold which had been held in the inactive gold fund, and the relaxation of the conditions on which the banks may lend to industry. In the United Kingdom, the policy of cheap money is being continued, and the cash reserves of the clearing banks were increased from £237.7 million to £243.2 million between June 1937 and June 1938. In France, Hungary and Switzerland, the central banks

have in recent months been empowered to undertake "open-market" purchases and sales of securities in order to regulate the supply of money and credit; and it is interesting to note that, whereas in 1929 the central banks of only two countries — the United States of America and the United Kingdom — used "open-market" operations as a normal instrument of monetary policy, there are now as many as nineteen countries which habitually use this instrument of control or which have recently been empowered to do so. In France, a number of additional measures have been taken to ease credit: the conditions on which the Bank of France makes advances have been relaxed; contractors have been enabled to mobilise their claims on the State or municipalities by drawing bills on them which may be rediscounted at the Bank of France; the acceptance of a bill of exchange has been made obligatory in all private transactions; and a new institution for the discount of bills is being organised on the lines of the London discount houses to stand between the Bank of France and the discount market.

Low interest rates and plentiful supplies of money and credit are a necessary condition for economic recovery; but it does not necessarily follow that in themselves they can have a very marked effect in counteracting the present decline in business activity, particularly in view of the fact that easy monetary conditions already existed in many countries, including the United States and the United Kingdom. In a number of countries, more direct measures have been taken to stimulate capital development by private enterprise. In France, tax remissions have been arranged for profits used for the renewal, extension or improvement of plant, for money spent on working-class house building, and for the production or the export of commodities in greater quantities than at present. In addition to this, 3,000 million francs are to be made available to be lent by the Government at cheap rates to private undertakings; and a seven-year development programme of the hydro-electric industry, involving a capital expenditure of 14,000 million francs, has been planned on the understanding that the Government will guarantee part of the interest payable on these capital sums. In Sweden also, a scheme has been devised whereby joint-stock companies will, in certain circumstances, be exempted from taxation on sums put aside into a special fund to be spent on real-capital development during years when trade needs to be stimulated. In the United States, measures have been taken, as is explained on page 23 of Chapter I, to stimulate expenditure on housing by Government action designed to increase the ease of financing building. Moreover, the

Reconstruction Finance Corporation, which had \$1,700 million of previous loans outstanding at the end of February 1938, has been empowered to lend a further \$1,500 million to business in order to stimulate private capital development.

This last measure, together with the recent measures of monetary expansion to which reference has been made above, was part of a comprehensive scheme of "lending and spending" to counteract the decline in business activity by means of increased expenditure. As a further part of this scheme, President Roosevelt proposed in April 1938 that \$1,462 million should be spent on public works in the financial year 1938/39, and that \$1,550 million should be allocated for relief of unemployment for the first seven months of the financial year 1938/39. This represents expenditure on relief and on public works at the rate of \$4,100 million a year, which may be compared with expenditure at the rate of \$2,007 million a year under these two heads during the previous eight months up to the end of February 1938. As the following figures show, the budget deficit in the United States had fallen very considerably since the payment of the veterans' bonus in 1936; but the newly planned expenditures on public works and relief have raised the estimated budget deficit for the financial year 1938/39 to a figure higher than that of any year except 1935/36, when the veterans' bonus was paid. Moreover, the estimated budget deficit of \$3,984 million does not take into account the sums which will be borrowed to finance the new loans of the Reconstruction Finance Corporation.

*United States Budget Deficit.**

\$(000,000's).				
1934/35	1935/36	1936/37	1937/38	1938/39 (as estimated at July 1938)
3,002	4,361	2,707	1,459	3,984

* The deficit is exclusive of the nominal deficit caused by the expenditure from the budget for the repayment of debt. As explained in Chapter I, the true deficit has fallen more sharply than the above figures suggest on account of the payment of part of the new social security taxes into a special fund for accumulation for future use.

In a number of other countries, increased expenditure on public works has been planned as a method of counteracting the recession. In France, a scheme of public works expenditure on a much more modest scale was announced in May 1938, according to which 11,000 million francs are to be spent on public works during the next two years and a further 10,000 million francs are to be devoted to a ten-year plan of improvement of rural and urban conditions. In the United Kingdom,

no definite plan of public works expenditure has been devised; but, in May 1938, the Ministry of Health suggested to the local authorities that a five-year programme of their capital works should be prepared, and pointed out that "by an ordered planning of their prospective capital works on a basis which will admit of adjustment, should circumstances make it desirable, local authorities can make a valuable contribution to the stabilisation of the conditions in industry over a considerable period". Perhaps the most interesting scheme of public works expenditure is that which has been planned in Sweden, where a valuable experiment had been successfully completed in speeding up loan expenditure on public works during the last depression and in repaying these loans from surpluses during the recent years of active trade. No other country has planned its action so carefully or so far in advance in order to be able to achieve an orderly expansion of public works expenditure. As a result of the enquiries of the Committee, to which reference has been made on page 40 of Chapter I, the future plans of capital works of the Swedish central and local authorities are now known for periods of five and ten years in advance. In May 1938, a separate emergency budget was voted for the expenditure of 231 million kronor on public works; but these sums are to be spent only if there is a substantial deterioration in the economic situation. In Switzerland, a scheme for the expenditure over a period of three years of 400 million francs on public works and national defence was announced in June 1938. In the Netherlands, a moderate increase in public works expenditure is foreseen for 1938. Similarly, in Hungary, New Zealand, Poland and Yugoslavia, public works schemes are being undertaken. In Canada, plans are under discussion for the introduction of a large-scale slum-clearance scheme. In the Argentine, a Public Works Council was instituted in June 1938 to ensure that public works should be prepared in a more orderly manner in the future.

In Germany, as has already been shown, there is at present a real scarcity of labour; and, except in the value of exports, there has been no fall in activity in recent months. This high level of economic activity is to be explained by sustained expenditure by the State, or under the control of the State, on armaments, public works and industrial investment under the four-year plan. On page 35 of Chapter I, figures have already been given to show how large a proportion of expenditure on capital development has been under the control of the State or of public authorities in recent years. According to the German Institute for Business Research, 72.6% of the total volume of building in 1937 was carried out directly for public

account, another 22.3% represented industrial construction which was carried out mainly under the four-year plan as a result of orders of the State, and only 5.1% represented private house building. The success of this programme of heavy expenditure by the State in preserving economic activity has been protected as far as possible from outside interference by a strict control of foreign trade and of all payments to foreign countries. This system has successfully reduced unemployment, and, up to the present, has been unaffected by the recession in other countries except for a fall in exports and a serious decline in security prices in August 1938. But this success has been achieved at a double sacrifice of the standard of living. In the first place, heavy expenditure on rearmament drains away men and other economic resources, which, if other measures of expansion had been undertaken, could have been used to produce goods or services of general utility. Secondly, the isolation of the economic system from foreign contacts sacrifices the advantages of international specialisation, so that, to quote two particular examples, artificial rubber is produced in Germany at a cost which is very much higher than the cost of natural rubber, and low-grade ores are worked within the country at an expense which is considerably higher than that of foreign high-grade ores.

The advantages of monetary expansion and of State expenditure on capital development schemes to prevent a threatened recession in business activity may be combined with the preservation of liberal international trading conditions, if a majority of the important industrial countries plan and time their schemes of internal expansion in co-operation. For, if all countries proceed at the same time, the danger that an adverse pressure on its balance of international payments will prevent any single country from taking measures of this kind will be reduced to a minimum. From the preceding paragraphs of this section, it appears that many more countries than in 1929 and 1930 have in recent months taken prompt measures of internal monetary expansion and expenditure on capital development to offset the recession. Moreover, the International Public Works Committee, recently instituted by the International Labour Organisation,¹ held its first session in June 1938, when it adopted a uniform plan for the supply of information by the different Governments about their public works schemes.

¹ Cf. Chapter VIII, page 165.

THE ECONOMIC OUTLOOK

At the end of July 1938, as the concluding section of this *Survey* is being written, the prospects of an early recovery in the United States of America appear to be improving; and the decline has given place to an upward movement.

Up to the present, the only aspects of economic recovery for which there is already definite statistical evidence are the recent rises in share prices and in commodity prices. The following figures show the extent of the rise in security prices, which started in the middle of June and was not checked until the second week of August 1938:

Dow-Jones Index of Industrial Share Prices.

Dollars per share.				
1937 August	June 18th	1938 August 7th	Percentage rise, June 18th to August 7th	
184	113	146	+ 29%	

This upward movement of share prices represents an improvement in the prospect of industrial profit; and — whether it be well grounded or not — such an improvement in the business outlook must in itself react favourably upon business enterprise and so upon business activity. As the above figures show, the improvement between the middle of June and the end of July restored almost one half of the losses in share prices between August 1937 and June 1938. But, on the other hand, it must be remembered that a similar rise of share prices, which occurred during the spring of 1930 after the stock exchange collapse of the autumn of 1929 and which is illustrated on the graph on page 191, proved to be only a temporary phenomenon and to be based upon a false expectation of recovery.

The recovery in share prices in 1930 was not accompanied by any appreciable recovery in other branches of economic life. Although, at the moment of writing, full statistical information is not available for the months of June and July, there is already some evidence that the recent recovery of share prices has been accompanied by some improvement in other fundamental branches of economic activity. In the first place, commodity prices have improved with the rise in share prices. This rise has been most marked in the case of primary products and of

raw materials in particular, and is illustrated by the following figures:

Annalist Index of Sensitive Commodity Prices.

(1913 = 100.)			
1937		1938	Percentage rise,
July	June 14th	August 2nd	June 14th to August 2nd
114.4	76.8	92.9	+ 21%

The prices of certain primary products, such as cotton and wheat, have continued to fall; but these two commodities are affected by the prospect of surpluses due to abundant crops. But the prices of such commodities as rubber, tin, copper and zinc have all risen considerably as a result of renewed buying and of reductions in available stocks.

It is generally believed that companies' stocks of goods have recently been considerably reduced from their excessively high levels by the severe curtailment of production below the rate of consumption, and that, as an end to this process is now in sight, some increase in demand for primary commodities has become necessary in order to increase production to meet consumption. In addition to this, in view of the more favourable business outlook and of the upward trend of commodity prices, the purchase of commodities for restocking may already have started. At the end of May 1938, wholesalers' stocks, according to the United States Bureau of Foreign and Domestic Commerce, after falling for the fourth consecutive month, were 14.5% below the level of May 1937; and in retail trade the stocks of Department Stores at the end of May 1938 were 9% below the level of May 1937.¹ It appears that, at the same time, some recovery in consumers' purchases has occurred. The Federal Reserve Board's index of Department Store Sales² rose from 78 to 82 between May and June 1938, after adjustment for seasonal variations; for although there was actually some fall in such sales, this fall was less than is normal at that season of the year.

There appears also to have been some recovery in production. The Federal Reserve Board's index for industrial production,³ after adjustment for seasonal variation, rose from 76 to 77 between May and June 1938, and this was the first rise to be recorded since August 1937. Capital construction appears to have shared in this improvement. Although building activity remains far below the 1929 level, the prospects of residential

¹ During the same period, department store sales had fallen by as much as 16%, so that there had been some rise in the ratio of stocks to sales.

² On the base 1923-1925 = 100.

building have been improved by the Federal Housing Act, to which reference has been made on page 23 of Chapter I; and the Federal Reserve Board's index for total building contracts,¹ after seasonal adjustment, rose from 51 to 52 between May and June 1938. Steel output has also improved recently. The rate of operation in the steel industry, expressed as a percentage of capacity, had fallen from 74.5 in June 1937 to 28.5 in June 1938, but had risen to 39.8 by the end of July 1938. Reductions in steel prices of between 7% and 17% had been made in June 1938; and this, by reducing the cost of capital equipment to a large number of important industries, may have stimulated expenditure on capital replacements, improvements and extensions.

These examples show that the recovery in the United States has spread beyond the stock exchange. But the indices of economic activity remain at low levels, and the improvements in the indices, other than those of the prices of shares and of primary commodities, have not yet been very great. Moreover, certain very important branches of economic life remain peculiarly depressed. Three of the main sources of demand for constructional goods in the United States are normally to be found in building, the public utilities and the railways. As has already been seen, building activity remains at a very low level in spite of recent signs of increasing activity; but the latent demand for houses must now be so great* that favourable conditions might bring a recovery in building which would greatly help the general restoration of economic activity. Construction expenditures by public utility companies are on a very low level in comparison with 1929 figures; and this is due, in part at least, to the uncertainty of their relations with the Government and to the possibility of increased Government competition in this field. But the position of the railways, whose capital replacements, improvements and extensions are of the greatest importance to the steel industry and to other heavy industries, is probably the most serious of all. Wage rates paid by the railways rose sharply in the second half of 1937, while carloadings fell rapidly in the last quarter of 1937 and the first quarter of 1938 as a result of the general recession. In consequence, the net operating revenue of all Class A railways fell from \$148 million to \$19 million between the first quarters of 1937 and of 1938. Many of the railways are now in great financial difficulties, and orders for capital equipment have fallen very seriously. Real improvement in building and in

¹ On the base 1923-1925 = 100.

* Cf. the table in the footnote on page 24 of Chapter I.

orders for capital equipment by the public utilities and by the railways would be sufficient to sustain a recovery; but such improvement has not yet made its appearance.

It is therefore too early to determine whether the recent recovery in the United States is permanent, or whether it marks merely a temporary halt in a larger downward movement. But it will be clear from the previous chapters of this *Survey* that the future trend of events in the United States is the most important factor affecting the development of the world economic situation. Although it is not possible to foretell the future course of events, the main influences, whether favourable or unfavourable to a rapid recovery, may be briefly enumerated. In the world as a whole there are a number of factors at work which tend to sustain the demand for goods and services and which were absent in the post-1929 depression. Government expenditure on rearmament is generally much higher than in 1930, and such expenditure shows no signs of an immediate reduction. The liquid reserves of the banks, both in the United States and in many other countries, are now much greater than in 1930, with the result that, in many countries, interest rates are low and there is no fear of the extensive banking and financial crisis which occurred in 1931. There is, moreover, a much greater readiness among monetary authorities and Governments to adopt prompt measures of monetary expansion and of public expenditure to offset a recession; and in the absence of a gold standard the national authorities are much less liable to be restrained from such policies by fears of their effect upon the balance of payments and the foreign exchanges. In the United States, there is now a considerable accumulation of needs of new capital equipment in many directions,¹ whereas the post-1929 depression followed a period of great capital construction; these accumulated needs of capital equipment, combined with the large programme of public expenditure to which reference has been made earlier in this section, must exert a very strong influence towards an early recovery. The absence during recent years of the large international movements of long-term capital which had taken place before 1929, means that there are no countries now whose economies are liable to be disordered by the abrupt cessation of such lending; and, since 1929, fixed interest payments on international debts have been scaled down through repayment,

¹ Cf. the figures in the footnote on page 24 of Chapter I. Further evidence of such accumulated needs of capital equipment is given in the *Financial Times*, July 20th, 1938. According to the *American Machinist*, the proportion of the capital equipment of the United States which was ten years old or more had risen from 48% in 1930 to 61% in September 1937. It is also estimated that, at the beginning of 1938, the railways were \$1,000 million behind in their appropriations for maintenance of way and structures alone.

conversion and default, and this also has reduced an item of great rigidity in the balance of payments of many countries. Moreover, in 1930, the United States adopted a policy of high protection at a time when the deepening depression was putting a strain on the export markets of other countries, whereas, at present, the commercial policy of the United States, whose favourable balance of trade has been greatly increased by the more rapid decline in her prices and incomes than in those of other countries, is based upon the liberalisation of trade through the Trade Agreements programme. For all these reasons, and also because of the increased reserves of many banking systems, recession is less likely to be intensified at present through deflation imposed upon debtor countries by sudden adverse movements in their balances of payments.

On the other hand, there are a number of unfavourable factors. First and foremost, it may be even more difficult now than it was in 1930 to restore confidence among businessmen and so to stimulate private expenditure on capital development. There are various reasons for this. The international political situation is much more alarming, and this breeds an atmosphere of insecurity which militates against business commitments. Closely allied to this are the adverse, as opposed to the stimulating, effects of heavy rearmament expenditure; for it may react unfavourably on private expenditure and private enterprise by underlining the sense of political uncertainty and by holding out the prospect of heavy and rising taxation, quite apart from the fact that it drains men and capital into economically unproductive uses. Increased Government intervention in economic affairs may also restrain business enterprise in certain ways. The prospect of policies which attempt to cure depressions through raising wage rates in order to increase purchasing power, may reduce the willingness of private business to embark on capital extensions in view of the prospects of higher operating costs. Other measures of economic reform, such as the control of the market for new security issues in the United States, may restrain activity by increasing the costs or the difficulties of obtaining new capital. Government intervention in economic affairs may also involve the possibility of increased competition by Government concerns with private enterprise; and, as in the case of the public utilities in the United States, this may reduce private expenditure on capital developments and extensions. In certain circumstances, public works expenditure may lead to a scarcity of certain types of essential labour, and so may react unfavourably on private activity. Moreover, as Governments become more and more liable to intervene in economic affairs, it is of increasing

importance that there should be good relations between Governments and business in order to avoid the growing uncertainty and suspicion which is bound otherwise to appear. As has been seen above, the abandonment of the gold standard and the consequent absence of rigid exchange stability is in one sense a favourable factor, since it allows individual countries to proceed with measures of internal expansion with less fear of the effects on their foreign exchange position. But this change also has an unfavourable aspect; for the possibility of exchange fluctuations not only increases the uncertainties of producers and traders of export goods, but it also gives rise to large-scale speculative movements of "hot" money. Such movements themselves may intensify the foreign exchange difficulties of certain countries, and, by leading to greater demands for liquid balances on the part of individuals and of banks, may in some countries hinder the attainment of conditions of easy money and credit. Finally, in the United States, there are prospects of bumper crops of cotton and wheat, as has been seen in Chapter III; and if this should give rise again to serious surpluses, reduced prices of farm products may exert an unfavourable influence on the economic situation.

In view of the many important changes in economic conditions since 1929 and of the opposing forces which are described above, it is still too early to answer the question whether the present recovery is permanent or not. But this question is of paramount importance and will in all probability be answered by the events of the next few months.

CHRONOLOGICAL

LIST OF MAIN ECONOMIC EVENTS

1937

AUGUST

1. *France*: Transport Board formed. Committee of fifteen members, presided over by Minister for Public Works.
Italy: Decree authorising Finance Minister to grant 3 milliard lira annually for the next five years to favour the production of synthetic rubber.
International: Foundation in Brussels of the "Association internationale des Cokes".
2. *Japan*: Government decides to provide further 400 million yen for North China; to be covered out of tax increases and by the issue of "Baby bonds".
3. *France*: Discount rate reduced from 5% to 4%.
4. *U.S.A.—U.S.S.R.*: Commercial Agreement signed for one year.
6. *Germany*: Introduction of control of wood production and consumption.
U.S.A.: Senate passes the Housing Bill authorising the issue of \$700 million bonds in the next three years to finance slum clearance and construction of new houses.
8. *Canada—France*: Commercial Agreement signed.
10. *Germany*: Introduction of control of leather consumption.
U.S.A.: Transatlantic Air-mail Bill approved.
11. *Germany*: Decree regulating selling prices of imported goods.
Poland: Embargo on grain exports is replaced by introduction of export control.
12. *Japan*: Domestic loan of 100 million yen, 3½%, issued at 98.50 for eleven years.
13. *Roumania*: Relaxing of exchange restrictions, foreigners' lei credits deblocked.
14. *United Kingdom*: Decision on creation of the Colonial Empire Marketing Board.

AUGUST

1937

20. *U.S.A.*: Senate votes law concerning repression of fraud against taxation.
21. *Japan*: Agreement between exchange banks to maintain the yen at 1s. 2d.
24. *U.S.S.R.*: Government approves the provision of pensions for all Soviet workers whether they cease work or not.
25. *France*: Further series of Decrees concerning measures for financial reform.

Japan: Bank of Japan adopts "open market" policy with a view to "improving credit conditions and facilitating the financing of industry" and revalues its gold reserves at the rate of 290 as against 750 milligrammes of fine gold per yen.

26. *U.S.A.*: New York Federal Reserve Bank rediscount rate reduced to 1%.
29. *France*: Abolition of the 10% tax on the dividend on *Rentes* held by individuals.

U.S.A.: President Roosevelt authorises the Commodity Credit Corporation to grant advances to cotton farmers.

31. *France*: New series of Decrees concerning financial reform programme.

SEPTEMBER

1. *Belgium*: Issue of 3½% Colonial Loan of 1 milliard francs for the repayment of a foreign loan and consolidation of Treasury bonds.

U.S.A.: President Roosevelt signs the Sugar Bill.

International: The International Sugar Agreement comes into force.

2. *France*: Discount rate lowered from 4% to 3½%.

6. *Australia*: Reduction of import duties on steel.

France: Ministry of Finance issues 5 to 10 year 5% bonds at 940 francs to consolidate the 4½% 1934 bonds due on October 5th, 1937.

Japan: Creation of an "Investment Company" with a share capital of 20 million yen to prevent the too rapid fall of shares.

7. *Ethiopia*: Prohibition of the use of the thaler for the purchase of goods in Ethiopia.

Germany: Creation of a "National Company for Ore Mining and Smelting".

8. *Mexico*: New import tax of 3% on 35% of the value of shipments.

9. *Brazil*: Bill introduced for the creation of a central bank.

SEPTEMBER

1937

10. *Australia*: Suspension of granting of mining concessions allowing free export of iron ore pending enquiry into adequacy of supplies.
Germany: The amount of Treasury bonds issued on August 2nd, 1937, is raised to RM 850 million.
13. *U.S.A.*: Treasury releases \$300 million of sterilised gold and decides the purchase in the open market of an indefinite amount of short-term Treasury bonds.
21. *Danzig*: League Loans Committee issues a statement concerning changes in the interest rates and final redemption dates of Danzig loans.
23. *Germany*: Minister of Economics decrees that all foreign securities must be registered with the Reichsbank.
27. *Italy*: The Minister of Finance decrees the obligatory cession of foreign credits in exchange for 5% 9-year Treasury bonds.
29. *International*: The European Timber Exporters' Convention reduces the 1938 export quotas by 10% as compared with 1937.

OCTOBER

1. *Germany*: A new Companies Act comes into force.
International: Re-establishment of the restrictions on copper production.
4. The "reprivatisation" of the three most important banks (Deutsche u. Diskonto Bank, Commerz. u. Privat Bank, Dresdner Bank) is completed.
7. *Portugal*: Exchange control abolished.
10. *Japan*: The import and export of certain goods prohibited.
11. *Czechoslovakia*: The Bank for International Settlements opens at the Czechoslovak National Bank a credit free of exchange restrictions for 100 million crowns.
12. *France-Switzerland*: A Swiss banking syndicate offers at 99 to the French State Railways a loan of 200,000 Swiss francs, 4%, for two years.
18. *Italy*: Decree imposing an extraordinary levy of 10% on the capital of joint-stock companies.
19. *Chile*: Declaration announcing the stabilisation of the currency at 25 pesos to 1 U.S. dollar.
United Kingdom: A plan for the reorganisation of the cotton industry published.
21. *Italy*: Abolition of the obligatory 25% cover on forward transactions.

OCTOBER

1937

22. *U.S.A.*: The Inter-State Commerce Commission authorises an increase in railroad freights.

23. *Japan*: Renewal of gold shipments to the United States. Restrictions on raw cotton imports.

International: The Wood-pulp Cartel between Sweden, Norway and Finland renewed for three years.

24. *Italy*: Financial measures concerning the ratification of issues in connection with the 1941 Exhibition, the financing of public works, and increases in the capital of the big industrial companies.

U.S.A.—Venezuela: Commercial agreement concluded.

International: The tin production quota fixed at 85% for the first quarter of 1938.

27. *Italy*: Supreme Autarky Commission set up.

U.S.A.: The Federal Reserve Board reduces the prescribed cover on credit purchases of securities from 55% to 40%.
Institution of obligatory cover on short sales.

29. *Argentine*: The export of wheat and flour prohibited.

30. *Germany*: Compulsory reduction of from 5% to 3% in the prices of certain products.

NOVEMBER

3. *Brazil*: The Minister of Finance announces a reduction of the export tax on coffee which amounts to 45 milreis a bag (60 kilogrammes) by 75%.

International: Signature of the Anti-Communist Pact between Germany, Italy and Japan.

10. *Brazil*: Nationalist *coup d'état*. Suspension of the foreign debt service from November 20th onwards. Prohibition of banks and insurance companies with non-Brazilian shareholders.

France: Payment of 3,127 million francs into the Banque de France from the Exchange Equalisation Fund.

12. *France*: Bank rate lowered from 3½% to 3%.

13. *France*: The Finance Minister announced repayment of the whole of the English loan of £40 million granted to France by a group of English bankers in February 1937, between December 2nd and 26th.

15. *Switzerland*: Entry into force of a series of measures adopted by the Swiss National Bank, in agreement with the private banks, with a view to stopping the influx of foreign capital.

26. *Germany*: Dr. Schacht's resignation of the post of Reich Minister of Economic Affairs accepted.

NOVEMBER

1937

30. *International*: Rubber export quotas lowered from 90% to 70% for the first quarter of 1938. Tea export quotas raised from 87.5% to 92.5% for the sixth year of control beginning on April 1st, 1938.

DECEMBER

1. *France*: Decree to authorise the issue of 2,000 million francs of 3, 6 or 9-year 5% Treasury Bonds at 955.
- International*: Re-entry into force of the Copper Quota Agreement, fixing production at 105% of the basic quotas.
6. *U.S.A.*: Issue of a Conversion Loan of \$450 million for five years at 1¾% and eight years at 2½%, to redeem \$450 million of Treasury bonds maturing.
10. *Japan*: New action by Finance Minister to strengthen exchange control.
- International*: Reduction of tin export quota to 70% — a drop of 40% — for the first quarter of 1938.
13. *Germany-United Kingdom*: Signature of a new Standstill Agreement in regard to frozen credits in Germany, prolonging the earlier Agreement expiring on February 28th, 1938, for one year without substantial change.
14. *France-Yugoslavia*: Signature of a Payments Agreement substituting a system of unrestricted commercial payments for the former clearing system, and of a rider to the Commercial Treaty of January 30th, 1929.
16. *Denmark*: New Monetary Law relaxing exchange control passed by Parliament. Substantial increase in free imports list.
17. *Germany*: Decision by the Government of the Reich to issue a Consolidation Loan of RM 1,000 million in the form of 4½% Treasury Bonds at 98¼, redeemable in eighteen years.
- Poland*: Reduction of Bank of Poland discount rate from 5% to 4½%.
18. *Germany-Italy*: Signature of a number of economic agreements.
- Germany-Netherlands*: Signature of a new Payments Agreement to run until December 31st, 1938.
23. *Brazil*: Decree conferring a *de facto* foreign exchange monopoly on the Bank of Brazil.
30. *Italy-Japan*: Signature of a Commercial Agreement.
31. *International*: Expiry of 1933 International Silver Convention. Conclusion of a number of provisional bilateral agreements by the United States (e.g., with Mexico and Canada) fixing the price of silver in the neighbourhood of 44 cents per oz.

1938

JANUARY

1. *U.S.A.*: Reduction of the price of newly-mined American silver from 77.57 cents to 64.64 cents per oz. The President may alter the new rate at any time.
5. *Norway*: Discount rate reduced from 4% to 3½%.
9. *Norway*: Issue of a 4% Conversion Loan of 100 million kroner at 98½%, redeemable in twenty-five years.
13. *France*: Tension on the exchange market.
14. *France*: Resignation of the Chautemps Cabinet.
15. *France-United Kingdom*: Conditions on the exchange market easier. Open intervention by the Bank of England to prevent too sudden a recovery of the franc.
19. *Canada*: Issue in London of a 3¼% Conversion Loan of £10 million sterling at 98½%, redeemable in 1958-1963.
France: Formation of a second Chautemps Cabinet. M. Marchandeu becomes Minister of Finance.
Germany: The German Internal Loan has been so well subscribed (see "Chronology", Germany, December 17th, 1937) that the issue will be raised from RM 1,000 million to RM 1,200 million.
21. *International*: The European Timber Exporters' Convention decides on a further reduction of 5% in export quotas. The total reduction for 1938 as compared with 1937 is 15%.
25. *International*: Rubber export quotas reduced from 70% to 60% for the second quarter of 1938.
27. *Netherlands*: Issue of a 1,672 million florins Conversion Loan, 3% until 1948 and 3½% for the following 28 years, at the rate of 99½%, free of coupon tax.
International: Publication of the van Zeeland report.
28. *Argentine*: Promulgation of a Decree reducing from 20% to 10% the exchange surtaxes levied on imports of certain classes of goods from countries with which the Argentine had an adverse trade balance.

FEBRUARY

4. *U.S.A.*: President Roosevelt signs the Federal Housing Act to promote the construction of cheap dwellings up to \$16 milliard.
7. *France*: Issue by the Crédit national of a 6% Lottery Loan of 1 milliard francs, at 940, redeemable in forty years. These bonds will be exempt for the whole of their term from the special taxes on negotiable securities.
9. *U.S.A.*: President Roosevelt asks Congress for further credits amounting to \$250 million for unemployment relief.

FEBRUARY

1938

14. *U.S.A.*: Mr. Morgenthau announces that the Treasury will partly abandon its gold sterilisation programme. This measure will have a retroactive effect as from January 1st, 1938.

Yugoslavia: Enactment of a Decree-law authorising the issue of Treasury bonds for 500 million dinars to meet urgent budgetary requirements, chiefly for national defence and for the economic reconstruction of the country.

16. *France*: Issue at 940 of 3 milliard francs of 5½% Treasury Bonds, redeemable in four, eight or twelve years.

U.S.A.: President Roosevelt signs the Crop Control Bill relating to a programme of assistance to farmers and to the regulation of the production of wheat, maize, cotton, rice and tobacco.

18. *International*: The International Tin Committee decides to reduce from 70% to 55% the authorised export quotas for the second quarter of 1938.

International: At the outcome of negotiations which have lasted for nearly two years, the European Zinc Rolling-mill Cartel has been constituted.

21. *International*: Prolongation of the International Rubber Regulation Committee for five years from December 31st, 1938.

MARCH

4. *France*: Laws constituting the "Code de la Paix sociale".

6. *France*: Law establishing a "Caisse autonome de la Défense nationale" with the task, as from January 1st, 1938, of meeting capital expenditure for national defence.

Hungary: The Government decides to put into force a Five-year Plan for the equipment of the country. The total cost of the proposed programme is estimated at 1 milliard pengö.

7. *Czechoslovakia-U.S.A.*: Signature of a commercial agreement with the most-favoured-nation clause.

Switzerland: Issue by the Federal Railways of a 3% Conversion Loan of 400 million francs, at par.

9. *Belgium*: Conclusion by the Government of a 4% Loan of 120 million florins from a group of Dutch, Swedish and Swiss banks. Proceeds are intended for the repayment in advance of the French 5½% Loans of 1932 and 1934.

10. *France*: Resignation of the Chautemps Cabinet.

12. *Japan*: The Bank of Japan reduces its discount rate and its rate of advances on securities, other than Government bonds, from 4% to 3.46%.

13. *France*: Constitution of a new Blum Cabinet.

MARCH

1938

14. *Austria-Germany*: Publication in the German *Official Journal* of the law providing for annexation of Austria.

China: Application of an Exchange Control Decree to prevent capital evasion.

17. *Austria-Germany*: A Decree gives legal currency to the Reichsmark and fixes the parity at 1 mark = 1.50 schillings. Another Decree transfers the management of the National Bank of Austria to the Reichsbank.

18. *Italy-United Kingdom*: Signature of a new Commercial Agreement and of an amendment to the Payments Agreement of December 6th, 1936. The Commercial Agreement provides for an increase of 27 ½% in the former import quotas into Italy of commodities other than coal. Both Agreements are to come into force on March 28th.

Mexico: Nationalisation on grounds of public utility of all foreign oil companies, these companies to be compensated in cash within a period of ten years.

23. *Austria-Germany*: Publication of a Decree providing for free entry of Austrian goods into Germany.

24. *Austria*: A new Decree prohibits exports of foreign exchange and the free disposal of securities to foreigners.

International: The United States ratify the International Sugar Agreement.

25. *France*: Parliament adopts the Bill submitted by the Government approving a new Convention between the State and the Bank of France raising the maximum of the latter's advances by 5 milliard francs.

27. *U.S.A.*: Mr. Morgenthau announces that the United States will discontinue their monthly silver purchases from Mexico as from April 1st, 1938.

28. *U.S.A.*: For the first time for two years, the Treasury lowers its purchasing price for foreign silver from 45 to 44 cents per oz.

29. *Lithuania-Poland*: Agreement signed on the opening of railway, road, air, postal and other communications.

U.S.A.: Reduction in the purchasing price of foreign silver from 44 to 43 cents per oz.

31. *Norway*: The Storting authorises the Government to issue a 52-million-crown loan for national defence.

APRIL

3. *Mexico*: The Bank of Mexico decides to suspend transactions for the purchase and sale of gold and foreign currencies. The convertibility of paper piastres into silver piastres maintained at the same rate and with no restrictions.

APRIL

1938

7. *Hungary*: Parliament grants full powers to the Government to put into effect the 5-year plan to be financed by a tax on capital amounting to 600 million pengő.
8. *France*: Resignation of the Blum Cabinet.
10. *France*: Formation of the Daladier Cabinet.
13. *Austria–Germany*: Abolition of restrictions on currency transfers between the two territories.
14. *France*: Special powers given to the Government to deal with the economic and financial situation and National Defence.
France–Italy: Signature of trade agreement abolishing the clearing system and restoring freedom of payments.
14. *U.S.A.*: In his message to Congress, President Roosevelt explained his scheme for stimulating business. This includes: \$2,062 million of advances by the Treasury to create employment in various ways; \$950 million to increase assistance credits to necessitous persons; \$1,500 million to be granted to business by the Reconstruction Finance Corporation, The Treasury desterialises \$1,183 million of gold blocked in the inactive gold fund, thus raising its working capital to about \$2,500 million.
14. *Yugoslavia*: The Council of Ministers decided to issue a 6% domestic loan for 4 milliard dinars, redeemable in fifty years, the proceeds to be used for major works and national defence.
17. *Mexico*: Parliament approved the issue of a national loan of 100 million pesos carrying no interest for the first ten years and 4% thereafter, to pay expropriation compensation to the oil companies.
18. *U.S.A.*: Mr. Morgenthau announces the abandonment of the gold sterilisation programme adopted at the end of 1936.
20. *Germany*: Issue of a 4½% domestic loan for RM 1 milliard at the rate of 98¾, redeemable in twenty years.
24. *Austria–Germany*: Extension to Austria of the German law on the currency and the Reichsbank.
25. *Ireland–United Kingdom*: Signature of a general agreement comprising various economic, commercial and financial Conventions.
29. *Argentine*: Reinforcing exchange control.
Brazil: Nationalisation of the oil refining industry.
30. *International*: The International Sugar Board decides to reduce the authorised export quotas by 5%.

MAY

1938

2. *France*: Publication of seven Decree-laws relating to financial recovery and providing, *inter alia*, for various measures concerning the budget, production, the opening of credits, etc.
International: Tube cartel renewed.
5. *France*: Devaluation and *de facto* stabilisation of the franc in complete agreement with the Governments of the U.S.A. and of the United Kingdom. In future, the rate of the franc will in no case exceed 179 French francs = £1 sterling.
7. *Germany*: The subscriptions to the German Internal Loan (see "Chronology", Germany, April 20th, 1938) have allowed the issue to be raised from RM 1,000 million to RM 1,600 million.
10. *Belgium*: The National Bank raises its discount rate from 2% to 4%.
12. *France*: The Bank of France reduces its discount rate from 3% to 2½%.
16. *France*: Issue of a 5% National Defence Loan of 5,000 million francs at 98, redeemable from 1941 to 1968.
18. *Canada*: Issue of a 2% and 3% loan of \$140 million, redeemable in six or twenty years, the yield to be devoted to the conversion of previous loans and to procuring fresh money.
France: A Decree authorises the Finance Minister to grant from Treasury funds non-interest-bearing advances to the Exchange Stabilisation Fund, and an order allows the Fund for the maintenance of *Rentes* to utilise provisionally its available assets for purchases of gold earmarked at the Bank of France.
21. *Turkey*: The National Assembly authorises the Government to issue a fresh loan of £T125 million for national defence requirements.
23. *Ireland*: Issue of a 3¼% Internal Loan of £10 million sterling at par, the yield to be devoted to settlement of the amount payable to the United Kingdom under the recent agreement.
25. *France*: Publication of fifty-three Decree-laws relating to the establishment of a programme of constructional work on a large scale, adjustment of the Law on the 40-hour week, the extension of credit to commerce and industry, etc.
27. *United Kingdom-Turkey*: Signature of a supplementary agreement to the Commercial and Clearing Agreement of September 2nd, 1936, and conclusion of an additional Payments Agreement and of a Convention relating to Turkish purchases of war material.
28. *Germany-Italy*: Conclusion of various agreements for the settlement of certain economic questions which have arisen as a result of the annexation of Austria.
30. *Belgium*: The National Bank decides to reduce its discount rate from 4% to 3%.

MAY

1938

30. *International*: The International Rubber Committee decides to reduce the export quotas authorised for the third quarter of the current year from 60% to 45% of the basic figures.

JUNE

1. *Roumania*: Issue of 4½% Internal Loan of 2,360 million lei, fully subscribed.
2. *Switzerland*: National Bank will advance 400 million francs to the Confederation, for execution of public works.
International: International Tin Committee decides to reduce exports authorised during the third quarter of 1938 to 45% of the basic figure.
3. *International*: International Tin-plate Cartel grants an increase of 2½% of quota to American producers.
U.S.A.—China: Prolongation of agreement on silver purchases.
8. *Sweden*: A law providing for annual holiday with pay passed by the Riksdag.
9. *Belgium*: A Dutch syndicate grants a short-term credit of 35 million florins to Belgium.
14. *United Kingdom*: Issue of second instalment of National Defence Loan, £80 million of 3% bonds, fully subscribed.
France: Publication of a further series of Decree-laws, relating to economic recovery.
15. *U.S.A.*: American Senate votes special labour regulation laws.
International: Steel cartel renewed.
16. *Afghanistan*: Exchange control introduced.
17. *Germany*: German Government announces its decision not to guarantee the service of Austria's foreign debts.
International: The International Copper Cartel decides to reduce output from 105% to 95%.
20. *International*: International Tin Committee decides to fix export quotas for third quarter of 1938 at 35%.
23. *Germany*: Forced labour service extended to all German citizens.
29. *France*: Publication of 102 Decree-laws relating to economic recovery. Bank of France authorised to undertake open market operations.

JULY

1. *Germany—United Kingdom*: Conclusion of a commercial and financial agreement covering the services of the Austrian loans and of other German loans.

JULY

1938

1. *Germany-Switzerland*: Signature of a Payments Agreement regulating transfers of currency relating to tourism and the service on interest owed to Swiss creditors.
 5. *Italy-Japan-Manchuria*: Signature of an agreement of commerce, friendship and navigation.
British India: The Government reduces the official rate of the rupee for the purchase of one pound sterling from 1s. 6¹/₃₂d. to 1s. 5¹⁵/₁₆d.
 7. *United States*: Passenger fares on the Eastern railways may be raised from 2 to 2½ cents a mile.
 10. *Germany-Turkey*: Conclusion of a commercial agreement providing for an increase of German exports to Turkey.
 13. *Germany-Finland*: Conclusion of an economic agreement providing for an increase in German payments for Finnish exports.
International: Prolongation for three years of the agreement regulating the output of the various nitrate producers.
 15. *United States-Netherlands*: Conclusion of an agreement for eliminating the double taxation of certain enterprises.
 18. *France*: Issue of a 3½% Loan for the National Defence.
International: The International Sugar Council decides to reduce by 5% quotas for the year 1938/1939, and these quotas are further reduced by voluntary surrenders.
 19. *France-Germany*: Conclusion of an economic agreement on all important commercial questions.
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**WORLD
ECONOMIC SURVEY**

EIGHTH YEAR

1938/39

LEAGUE OF NATIONS

GENEVA

1939

ECONOMIC INTELLIGENCE SERVICE

**WORLD
ECONOMIC SURVEY
EIGHTH YEAR
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GENEVA

1939

**Publications of the Economic Intelligence Service
of the League of Nations**

MONTHLY BULLETIN OF STATISTICS.

STATISTICAL YEAR-BOOK OF THE LEAGUE OF NATIONS.

WORLD PRODUCTION AND PRICES.

REVIEW OF WORLD TRADE.

BALANCES OF PAYMENTS.

INTERNATIONAL TRADE STATISTICS.

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II. ECONOMIC AND FINANCIAL

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WORLD ECONOMIC SURVEY

Eighth Year

1938/39

PREFACE

The object of this *Survey*, like that of its predecessors, is to furnish the general reader with an account of the more important economic developments during the past twelve months, based primarily on the information collected in the preparation of the more specialised studies contained in the other publications of this Service. The *Survey* is, however, more than a simple synopsis of these other publications, a list of which is given on page 2; it covers a somewhat wider field and in its preparation additional sources of information have been employed and assistance has been obtained from other national and international bodies — more especially from the International Labour Office.

The present issue has been prepared by Mr. J. E. Meade, temporarily attached to the Economic Intelligence Service.

As in other publications of the Economic Intelligence Service, the sign “—” indicates throughout that the figure is nil or negligible, “...” that the figures are not yet published, and “.” that information is not available or is non-existent. World and continental tables contain, as a rule, estimated figures for countries for which information was not available, so that they are complete and therefore comparable from year to year.

A. LOVEDAY,

*Director of the Economic, Financial
and Transit Department.*

Economic Intelligence Service,
Geneva, September 1939.

Chapter I

RECESSION AND RECOVERY DURING 1938

The last *Survey*, which covered the period from the middle of 1937 until the middle of 1938, was devoted to an analysis of the decline in business activity which developed during that period. Recovery from the great post-1929 depression continued from 1932 until 1937 and then gave place to a recession which, in many respects, was comparable to the first stages of depression in 1929 and 1930. This recession was particularly marked in the United States of America. But, as was shown in the *Survey, 1937/38*, the vast majority of industrialised countries were affected by it. The countries which depend upon the production and export of primary commodities were adversely affected by the rapid decline in the demand for their products on the part of their industrialised customers; and, as their demand for imports showed the usual delay in adjusting itself to the lower value of their exports, they were faced again with a severe pressure upon their foreign exchange position.

But, in the course of 1938, this movement was reversed. In the middle of the year, the exceptionally rapid decline of production in the United States gave place to a rise the rapidity of which was equally exceptional. This recovery was at first accompanied by a considerable rise of security prices, although commodity prices continued to fall. In the United Kingdom, the decline in production and employment was halted in the last half of 1938, although security prices and commodity prices continued to decline throughout the year. France was in the peculiar position of having experienced practically no recovery from the post-1929 depression, which in her case had been delayed by the deflationary policy adopted until 1936. But, by the end of 1938, there were signs of a marked improvement in the conditions necessary for a recovery of economic activity.

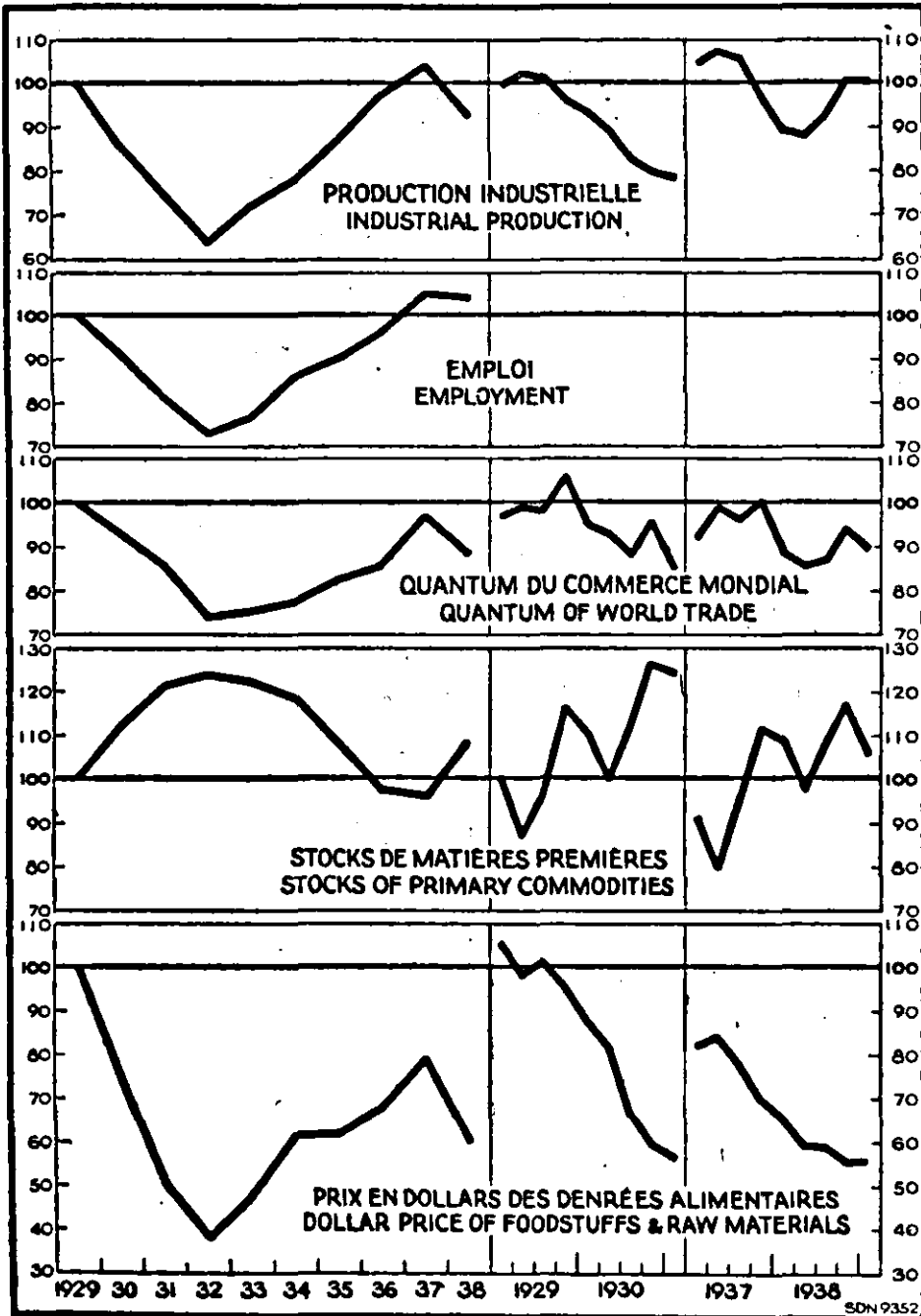
The same change in trend was to be observed in a number of other countries. Indices of industrial production, for example, showed a decline during the last half of 1937 and the beginning of 1938 and a subsequent rise to the end of 1938 in countries with as varied economic structures as Canada, Sweden, Belgium,

World Indices of Business Activity.

(1929 = 100.)

Annual figures, 1929 to 1938.

Quarterly figures, 1929 to 1931 and 1937 to 1939.



Sources: Industrial Production: League of Nations index, world excluding U.S.S.R. Employment: International Labour Office index of numbers in industrial employment, quarterly figures not available. Quantum of World Trade and Stocks of Primary Commodities: League of Nations indices. Dollar Price of Foodstuffs and Raw Materials: Survey of Current Business.

the Netherlands, Denmark, Bulgaria, Estonia, Finland and Roumania. On the other hand, in Germany, Italy and Japan, whose economies were already dominated by the economic activity of war or of war preparations, internal activity had shown no decline; and, as a position had been reached at which there was practically full employment of all the available economic resources, production ceased to expand during 1938, or expanded at a considerably lower rate than in previous years. In these countries, the continued expansion of public expenditure and of the monetary circulation gave rise, in a more acute form, to problems of State control of prices, consumption and the allocation of resources, in order to drain economic resources from private to public employment without incurring an inflationary rise of prices.

These changes in the general trend of economic activity are well illustrated by the available world indices of different aspects of economic life. The graph on page 8 shows that, for the world as a whole, production, employment, commodity prices and the quantum of international trade all fell from 1929 to 1932 and rose again from 1932 to 1937. Stocks of primary commodities, on the other hand, increased from 1929 to 1932 and fell again from 1932 to 1937. By 1937, industrial production and the number of workers in employment were somewhat above the 1929 level, and the quantum of international trade was slightly below the 1929 level. On the other hand, although by 1937 stocks of primary commodities were already 5% lower than in 1929, their prices were still some 20% below the 1929 figure.

From 1937 to 1938, production, employment, the quantum of world trade and the prices of primary commodities all declined; and stocks of primary commodities rose. But quarterly figures of these indices show that there was a marked change of trend during 1938; and it is of interest to compare the movements of these quarterly figures during 1937 and 1938 with those during 1929 and 1930, which marked the onset of the great depression. The most marked contrast between these two periods is to be found in the index of industrial production. The graph shows that, whereas industrial production fell consistently during 1930, it recovered rapidly during the last half of 1938 and by the first quarter of 1939 was only 3.9% below its level in the corresponding period of 1937. The quantum of world trade fell more rapidly in the first half of 1938 than in the corresponding period of 1930; but there was a marked rise in the last half of 1938, whereas in the corresponding period of 1930 the rise was less than could be accounted for by seasonal influences. Moreover, stocks of primary commodities rose during the last

half of 1938 much less rapidly than they had risen during the last half of 1930 ; but the prices of primary commodities continued to fall during 1938, although at a less rapid rate than during 1930.

Apart from changes in the underlying economic conditions, there are two important differences of economic policy between 1930 and 1938 which help to explain why recession, which developed into a major depression in 1930, was halted during 1938. In the first place, a policy of monetary expansion and of increased public expenditure on public works and other civil purposes was promptly adopted in the United States during 1938; and this change of policy was accompanied by similar action in a number of other countries. On the other hand, in 1930, not only was there no such conscious attempt to offset depression by a public policy of expansion, but many States whose currencies were endangered by the cessation of foreign borrowing, by the export of capital or by less favourable trading conditions were forced to take positive measures to speed up the process of internal deflation. In Chapter III, reference will be made to the policies which were adopted during 1938 to maintain plentiful supplies of money and low interest rates; and in Chapter II, a number of examples are given, both of countries which, like Sweden, have adopted a policy of timing their public expenditure so as to offset a decline in private activity and also of countries, such as Poland and Turkey, which have adopted long-period plans of public construction, the prosecution of which may be expected to reduce the magnitude of any internal depression of activity.

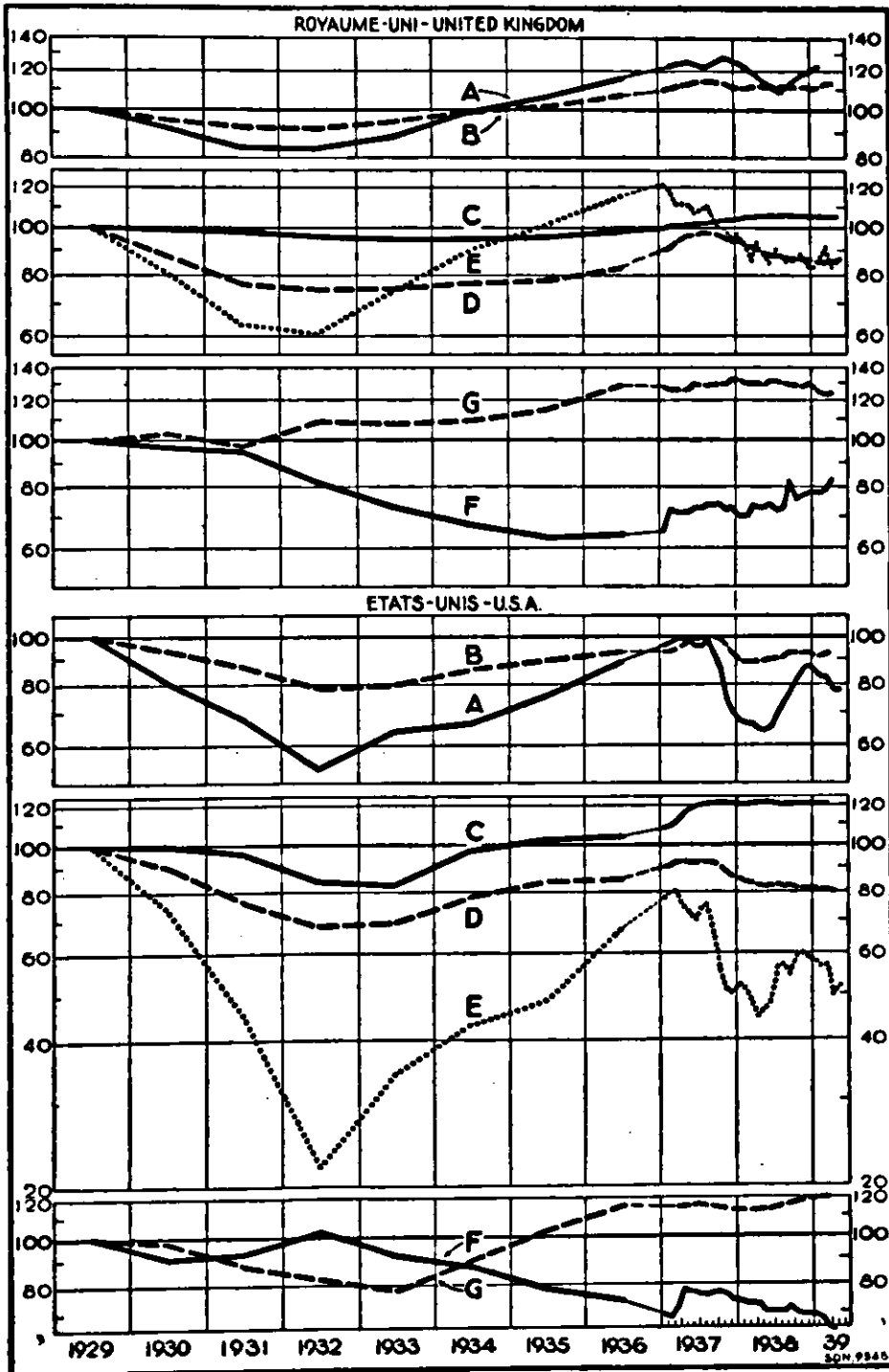
The second decisive factor which arrested the recession of 1938 was State expenditure upon armaments.¹ In countries such as Germany and Japan, this expenditure had already reached such a level, and had already led to so many controls of the national economy, that no internal depression was experienced during 1938. In other countries, such as the United Kingdom and France, expenditure on armaments had not developed on a similar scale, and comparatively few State controls had been introduced into the economic system; nevertheless, in these countries also, substantial increases in expenditure on armaments during 1938 and the prospect of still greater increases during 1939 constituted an important factor in the maintenance of economic activity. Indeed, as will be seen in Chapter IX, economic problems are being progressively dominated by considerations of international politics. In such circumstances, economic fluctuations are no longer subject in

¹ Cf. Chapter II.

Economic Conditions in the United States and the United Kingdom.

(1929 = 100.)

A Industrial production. C Money wage rate. F Yield on Government
 B Number employed. D Wholesale prices. bonds.
 E Share prices. G Supply of money.*
 (Logarithmic scale.)



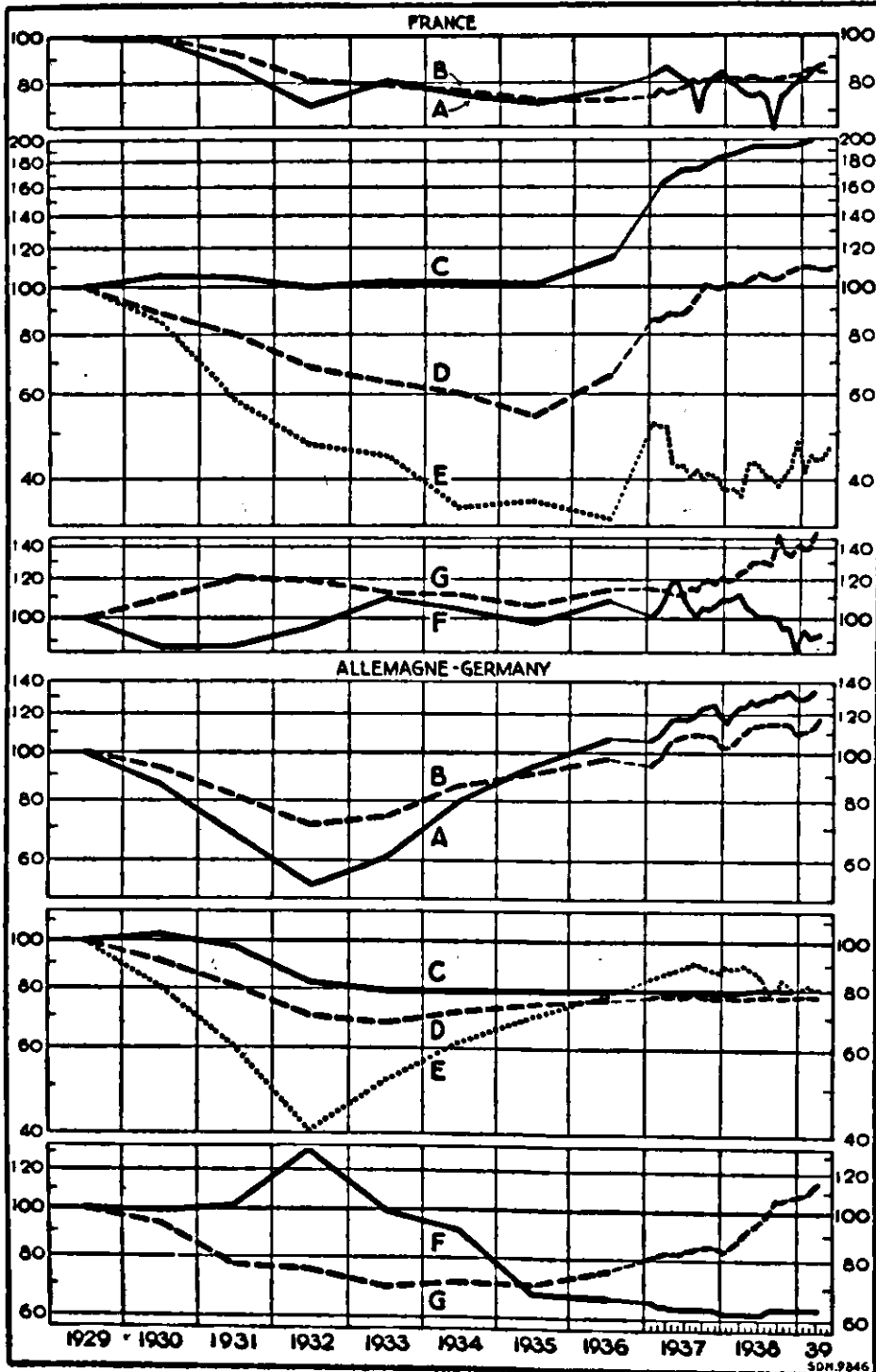
* United States: Total deposits of all member banks, plus cash in circulation, minus cash in vaults of member banks. United Kingdom: Total bank deposits, plus estimated net circulation of currency.

Economic Conditions in France and Germany.

(1929 = 100.)

A Industrial production. C Money wage rate. F Yield on Government bonds.
 B Number employed. D Wholesale prices. G Supply of money.*
 E Share prices.

(Logarithmic scale.)

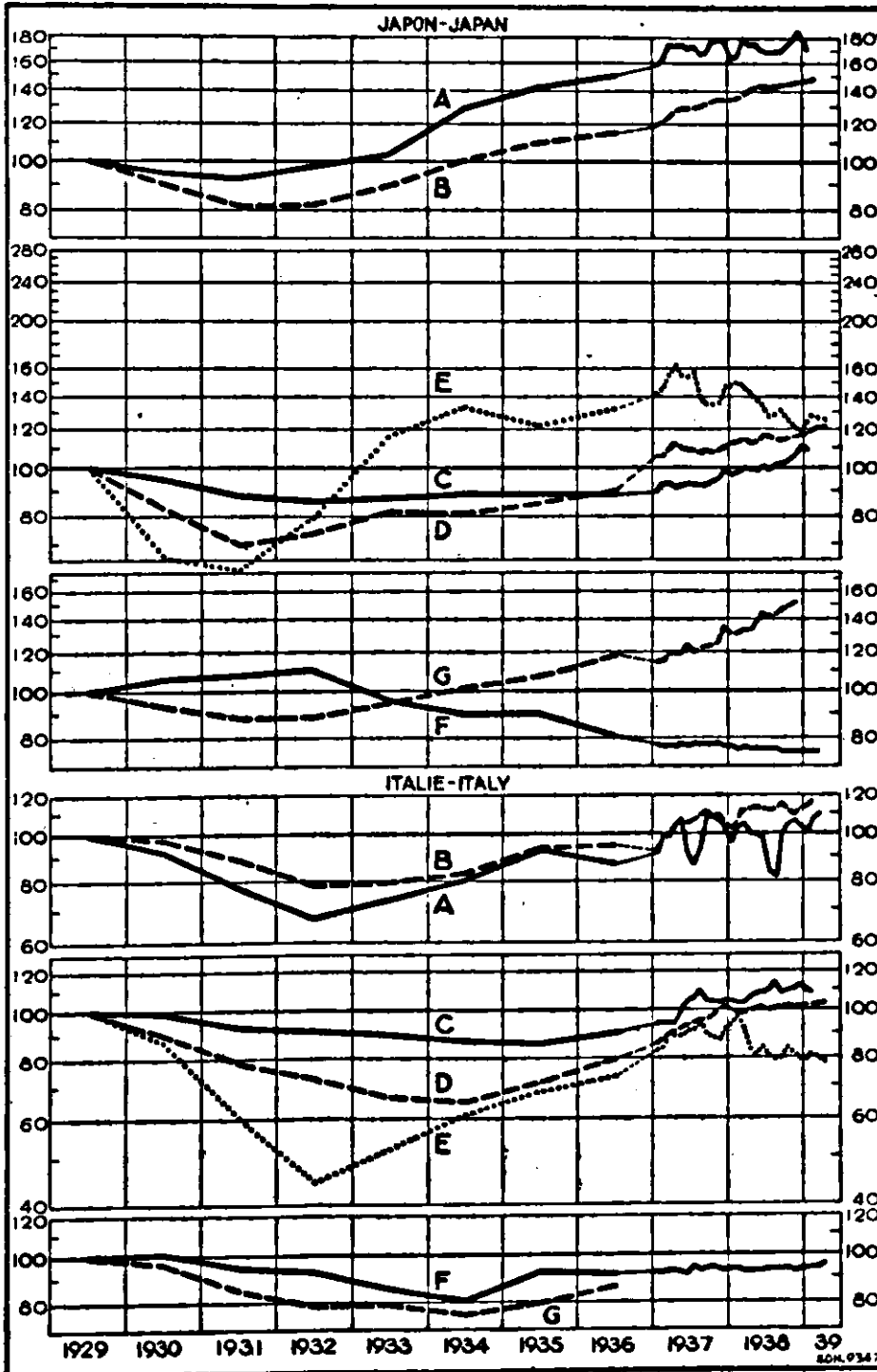


* France: Total deposits of four leading commercial banks, plus total note circulation.
 Germany: Total commercial bank deposits, plus note circulation and coin, except coin held by Reichsbank.

Economic Conditions in Japan and Italy.

(1929 = 100.)

- | | | |
|---------------------------------|----------------------------|-------------------------------------|
| A Industrial production. | C Money wage rate. | F Yield on Government bonds. |
| B Number employed. | D Wholesale prices. | G Supply of money.* |
| | E Share prices. | |
- (Logarithmic scale.)



* Japan: Total commercial bank deposits, plus net circulation of notes, exclusive of notes held by other banks of issue. Italy: Total commercial bank deposits, plus total note circulation.

the same degree to the laws of a more normal and more liberal peace-time economy.

These changes in the general trend of economic activity are illustrated for six important industrialised countries by the graphs on pages 11 to 13. The remaining sections of this chapter are devoted to an analysis of the trends in these countries and to the effect of these changes upon the trading position of countries which depend upon the export of primary commodities.

THE UNITED STATES OF AMERICA

The general nature of the recovery of economic activity in the United States since the middle of 1938 is illustrated by the graph on page 11. The upturn started with a rapid rise in security prices; but this was immediately followed by an even more rapid and more marked rise in industrial production. In fact, production rose by as much as 35% between June and December 1938. This increase is the greatest which has occurred in any recorded six months of American experience. As normally occurs in the process of depression and recovery, the production of capital goods, which had fallen much more rapidly than the production of consumption goods between the middle of 1937 and the middle of 1938, in turn rose much more quickly in the second half of the year.¹ Employment also turned upward in the second half of 1938; but, as is usual, its previous fall and its subsequent rise were less pronounced than in the case of production. Interest rates continued to fall during 1938, after rising at the beginning of 1937. This development was due largely to monetary policy; for the total supply of money declined during 1937 and rose again during the last half of 1938. On the other hand, in spite of this general recovery, wholesale prices continued to decline throughout the year.

Recession in trade activity in the United States in 1937 and 1938 exerted considerable pressure upon the prosperity of other countries; for the reduced prices and buying power in the American market led to a rapid fall in American imports, while American exports continued for some time to increase and subsequently fell much less than imports. The following figures show how severely American purchases from the rest of the world fell with the onset of the internal recession in the middle of 1937, and how this caused an excess of imports in the first half of 1937 to give place to a large excess of exports.

¹ Cf. Chapter IV.

United States: Value of Imports and Exports.

\$ (000,000's).

	1937				1938				1939
	I	II	III	IV	I	II	III	IV	I
Exports .	701	806	832	960	815	755	697	790	691
Imports .	785	839	746	642	492	450	492	516	513
Excess of exports (+) or of im- ports (—)	— 84	— 33	+ 86	+ 318	+ 323	+ 305	+ 205	+ 274	+ 178

As a result of the recovery which started in the middle of 1938, imports have again risen to a certain extent, and this has resulted in some diminution of the American export surplus. But, since the United States is both a creditor country and also a country to which large sums of capital are being transferred, this continuing excess of American exports still exerts a pressure upon the external economic conditions of other countries.

The causes of the recession in the United States were examined at length in the previous issue of this *Survey*.¹ They may be briefly recapitulated here. Certain monetary measures had been taken during 1936 and 1937 to prevent the danger of inflationary and speculative developments. The conditions on which persons could purchase securities with borrowed money were restricted; the cash reserve ratios which the member banks were legally required to maintain against their deposit liabilities were increased; and a policy was adopted whereby imported gold was bought for an "inactive gold fund" by the Treasury, in order to prevent it from swelling the cash reserves of the banks. This policy led to a moderate rise in interest rates, which may in some measure have restricted the possibilities of profitable economic expansion. During the same period, there was a substantial rise in the raw-material and wage costs of construction, which constituted an important obstacle to expenditure upon capital development.

Another important item in the causation of the American recession was the change in the budgetary situation. Whereas in 1936 expenditure for the Federal Budget had been swollen by the payment of the Veterans' Bonus, in 1937 expenditure was reduced and tax revenue was increased substantially, so that the net contribution of the State to the demand for goods and services was greatly restricted. When account is taken of the raising of social security taxes, a large part of which

¹ Cf. *World Economic Survey, 1937/38, Chapter I, pages 13-24.*

are accumulated in a special fund outside the budget, it appears that the excess of Government expenditure over Government revenue was reduced from some \$4,500 million in 1935/36 to less than \$400 million in 1937/38.¹

Certain other important factors were at work in causing the depression. Companies' stocks of raw materials and goods in process of manufacture had risen very steeply during the last half of 1936 and the first part of 1937; and, in order to restore these stocks to more manageable levels, merchants and manufacturers reduced their demands below the level which corresponded to the current level of their sales. Moreover, the fall in security prices which accompanied the recession constituted in turn a reason for its intensification. During the last half of 1937, the market value of all shares quoted on the New York Stock Exchange fell by as much as \$20,000 millions²; and such extensive capital losses must greatly have restricted the willingness of property owners to incur expenditure of any kind. Finally, the relations between the leaders of business and the Administration were uneasy, and this uneasiness accentuated the unwillingness of private enterprise to embark on further projects of capital expenditure which might have helped to sustain the economy.

In the course of 1938, all these factors were reversed. In particular, the reversal of the American monetary policy from one of restriction to one of expansion and the change in the American budgetary policy from one of economy and of increased tax revenue to one of renewed emergency expenditure have been decisive factors. The threat of a possible major depression was met by the prompt application of a policy of monetary expansion combined with increased public expenditure from borrowed funds. It is improbable that full recovery will be enjoyed in the comparatively liberal economy of the United States unless there is a substantial recovery in private expenditure upon capital development; and in fact the recovery was checked in the first quarter of 1939. Nevertheless the change of public policy has averted the danger of a cumulative deflation developing out of the recession of 1937, as it did out of that of 1929.

The change in monetary policy occurred in the last half of 1937 and the first half of 1938. In the last half of 1937, the Federal Reserve Banks reduced their discount rates; the rules restricting the type of paper which might be rediscounted with the Reserve Banks were modified; the restrictions limiting the

¹ Cf. the table given in Chapter II, page 74.

² This figure is as much as 28% of the United States national income for 1937.

purchase of securities on the Stock Exchange from borrowed money were relaxed; some part of the gold held by the Treasury in the "inactive gold fund" was released, and thereby increased the cash reserves of the banking system; and the Reserve Banks increased the supply of credit to a small extent through small purchases of Government securities in the open market. But these changes were only preliminary to the two main methods of monetary expansion, which were utilised in the first half of 1938. The whole of the "inactive gold fund" was abolished; and, in consequence, new gold imports and the existing stock of gold held in the fund were added to the cash reserves of the banks. In addition, the legal minimum reserve ratios which the member banks were required to hold against their deposits were substantially reduced. These two measures in combination greatly increased the excess reserves held by the banks — *i.e.*, their reserves over and above that part which constituted a legal backing to their deposit liabilities; and this, in turn, led to a great easing of monetary conditions. Moreover, the use by the Treasury of the gold in the "inactive gold fund" enabled the Government to finance its expenditure for some time without recourse to the issue of new loans, and the absence of such public borrowing helped to reduce the cost of borrowing by private enterprise. Finally, there was a substantial relaxation of the rules governing the security upon which the commercial banks might extend loans to their customers.¹

The following figures illustrate the effects of this change in policy. The total supply of deposit money fell during 1937, but rose again substantially during 1938. The excess reserves of the member banks were also sharply reduced during the first half of 1937, but rose again to a very high level in 1938. Meanwhile, the rate of interest rose as excess reserves fell and as monetary conditions became more restricted; but it was reduced again as soon as excess reserves increased.

United States: Monetary Supply and Interest Rates.

	Deposits of weekly reporting member banks	Excess reserves of member banks	Yield on Treasury bonds
	\$ (000,000's)		%
December 1936	20,638	1,984	2.51
July 1937	20,301	791	2.72
December 1937	19,636	1,212	2.67
July 1938	20,144	3,022	2.52
December 1938	21,146	3,205	2.49

¹ The monetary policy is discussed in greater detail in Chapter III below.

The change in budgetary policy was initiated in April 1938, when the President proposed a programme of Government expenditure on relief and public works, together with the provision of additional loans to industry through the Reconstruction Finance Corporation. The total additional expenditure foreseen by Congress was \$3,753 million; and, at the beginning of 1939, the President asked for an additional \$875 million for relief expenditure.

The effect of this change is well illustrated by the following figures:

United States: Net Surplus (+) or Deficit (—) of Government Receipts over Government Expenditure.¹

\$ (000,000's).

	1936	1937	1938	1939
Quarters: I . . .	— 281	— 73	+ 130	— 498
II . . .	— 1,753	— 284	— 621	...
III . . .	— 1,167	+ 58	— 466	...
IV . . .	— 935	— 42	— 758	...

The large deficits of 1936 had given place to an appreciable surplus by the third quarter of 1937. The recent policy of increased public expenditure did not come into effect before the third quarter of 1938; and the reappearance of a deficit as early as the second quarter of 1938 must be ascribed to the automatic effects of the depression in causing a fall in tax revenue, an increase in the number of persons needing relief, and a rise in agricultural adjustment payments to farmers as a result of the fall in agricultural prices.

The recovery in the United States has been greatly helped by a rapid expansion of building activity, which has been very marked in residential building, as the following figures show:

United States: Building Activity.

(1929 = 100.)

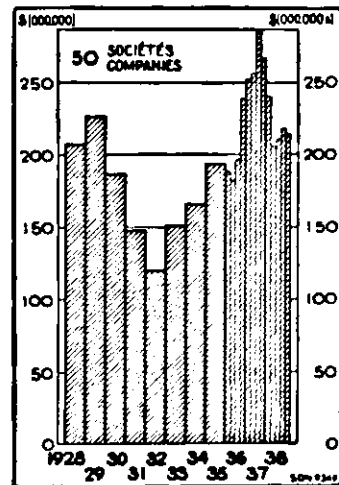
	Value of contracts awarded	
	Residential building	All building
1934	13	18
1935	25	27
1936	42	41
1937	47	48
1938	51.5	48
December 1937	27	40.5
December 1938	57	65

¹ These figures make allowance for certain public expenditures and revenues, such as part of the Social Security levies, which do not pass through the budget. Receipts exclude the proceeds of publicly issued debt, and Expenditure excludes the repayment of such debt.

Residential building, which had fallen to very low levels during the great depression, was one of the few branches of economic life, the activity of which, on the average, was higher in 1938 than in 1937. There has been a very marked rise in house-building between the end of 1937 and the end of 1938. This recovery is probably due to the combination of a number of factors. Housing legislation in 1938 relaxed the condition on which mortgages could be raised to finance house-building, and — what was more important — increased the facilities for building houses to let. The rise in building costs and wages, which had been rapid during the first half of 1937, ceased in the middle of that year, and there has been some subsequent fall in costs. The fall in interest rates during 1938 has also helped to reduce the costs of borrowing for house-building; and the general recovery in business activity since the middle of the year has helped to stimulate the building trade. There is, however, evidence that more fundamental factors were at work, and that an upturn of house-building was to be expected, in conformity with a long-period cycle of housing activity; the scarcity of houses which had developed since the last building boom in the 1920's justified renewed activity.¹

Others of the factors mentioned above on page 16 as possible causes of the recession in the United States were removed in the course of 1938. The accompanying diagram shows how the excessive rise in companies' stocks during 1936 and 1937 had been rectified, at least to a large extent, by the middle of 1938. Manufacturers were then in a better position to produce on a scale commensurate with their customers' demands instead of attempting merely to work off unwanted stocks. The decline in security prices gave place to a considerable recovery in the middle of 1938; and this helped to restore the willingness of private individuals and of private enterprise to incur expenditure. Finally, there

*Company Inventories in the United States.**



¹ Cf. J. TINBERGEN, *Statistical Testing of Business-cycle Theories*, Volume I, "A Method and its Application to Investment Activity". League of Nations, 1939, pages 98 and 99.

* The diagram is taken from the *Cleveland Trust Company Business Bulletin*, January 15th, 1939. The figure for the first quarter 1939 is provisional.

was a considerable improvement in the course of the year in the relations between business men and the Government, and this helped to restore confidence.

In the early months of 1939, frequent announcements were made on behalf of the Administration to the effect that economic recovery rather than reform would constitute the main objective of Government policy; and agreement on the terms on which the Tennessee Valley Authority was to purchase certain competing public utilities alleviated the sense of uncertainty which had held back expenditure on capital equipment in this important branch of business.

In 1938, public policy appeared to have averted the onset of a major slump; but recovery was by no means complete. Certain branches of economic activity, such as the railways, continued in a condition of serious depression, in spite of the recovery; and many other branches of activity had failed to recover fully. There were probably in reality many openings for capital development, in view of the low level of expenditure on capital equipment since the onset of the great depression in 1929, and in view of the increase in the population which had occurred since then.¹ The most important factor which held back the recovery of private enterprise was probably the continued sense of uncertainty. For as relations between business and the Administration improved, the international political outlook quickly deteriorated.

THE UNITED KINGDOM

The recession in the United Kingdom at the end of 1937 and during the first half of 1938 was much less rapid than in the United States; and, as the graph on page 11 shows, the recovery in the last half of 1938 was also much less marked. In the United Kingdom, there was a continued fall throughout the year, not only of commodity prices, but also of security values, which have often provided a correct indication of the future course of business activity. On the other hand, industrial production, which had fallen rapidly during the first three quarters of the year, rose more than seasonally in the last quarter. Employment, which had grown steadily since 1932, ceased to increase at the beginning of 1938; and it did not restart its growth during the year.

The graph shows that there was some rise in interest rates in the course of the year, which was partly caused by the prospect

¹ For some reference to the accumulated needs of capital equipment, see *World Economic Survey, 1937/38*, Chapter I, page 24.

of heavy Government borrowing for rearmament purposes and partly by a reduction in the supply of money which occurred during the year. This restriction in the monetary supply, which was indirectly caused by the export of capital to the United States and to France, will be discussed in greater detail in Chapter III. But these changes were very moderate. On the whole, 1938 was another year of plentiful monetary supplies and of low interest rates.

The fact that recession was halted in the United Kingdom in the last half of 1938 was perhaps as significant as the rapid recovery in the United States; for the United Kingdom, unlike the United States or France, had enjoyed five years of continuous recovery, which by 1937 had brought the level of production some 24% above the 1929 level; and past experience has shown that a major depression is by no means abnormal after a recovery of this magnitude and duration. During these years of recovery, expenditure on the maintenance and development of capital equipment had been raised to a high level; and there was little or none of the accumulated needs of capital equipment which might be expected to maintain activity in the United States or in France. To mention only one example: whereas in the United States accumulated housing shortages helped to restore activity to the building trade and so to the economy in general, the building trade in the United Kingdom had recently passed through a period of boom. The long expected down-turn in building activity in the United Kingdom had already started in 1937, as a result of the fact that the needs for houses had been largely met, at least for those classes which could afford unsubsidised housing. The contrast between the two countries is well shown by the following figures:

United Kingdom and United States: Residential Building Activity.

(1929 = 100.)

	United Kingdom: Value of permits in 146 localities	United States: Value of contracts awarded in thirty-seven States
1932.	106	15
1933.	141	13
1934.	157	13
1935.	177	25
1936.	170	42
1937.	153	47
1938.	136	51.5

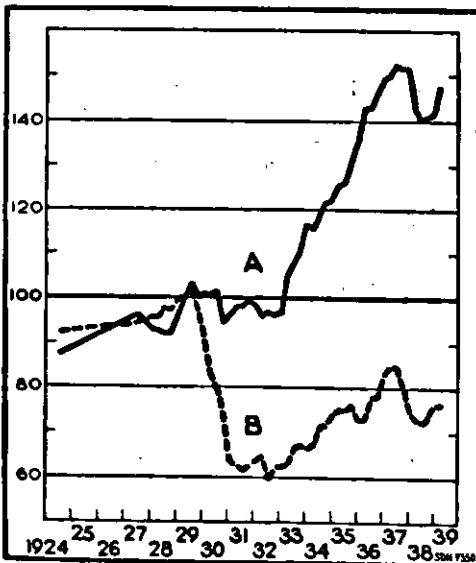
The recession in the United Kingdom was naturally intensified by the recession in the United States and in other countries.

For the recession in world markets was the direct cause of a fall in British exports and so, by a series of repercussions, of a decline in a number of branches of activity. Moreover, the psychological effects upon confidence of the recession in the United States accentuated the decline of activity in the United Kingdom by causing business men to attempt to cut down their commodity stocks and to refrain from any avoidable expenditure, in the expectation of continued price declines.

But the decline of activity in the United Kingdom cannot be entirely explained as a result of the setback in the United States. There is evidence that the recession in the United Kingdom was due more to internal causes, and less to depression in other countries, than was the case in 1929. Evidence of this is provided by the accompanying graph. Between 1924 and 1929, production for the home market and for the export market expanded together; but, with the onset of the great depression in 1929, there was a very heavy fall in production for the export market, while production for the home market fell only slightly.

*Output for Home
and Foreign Markets:
United Kingdom, 1924-1938.¹*
(1929 = 100.)

- A Output for home market.
- B Output for foreign market.



suggests that the post-1929 depression in the United Kingdom was primarily due to the repercussions of the depression in other countries and to the consequent contraction of British markets. There do not appear to have been any strong internal factors contributing to the depression. The decline between 1937 and 1938, however, seems to have been as marked in the production for the internal market as in that for the export market. This contrast suggests that, after the great expansion of internal activity between 1932 and 1937, the United Kingdom economy would have been liable to experience a depression from internal causes in the absence of abnormal rearmament activity.²

¹ The diagram is reproduced from *The Economist*, December 24th, 1938, page 648.
² If sufficient weight were given to production for rearmament in recent years, the index of output for the home market would have shown a much smaller decline

This conclusion is also strengthened by the movements of the United Kingdom foreign trade. The following figures show that, between 1929 and 1930, the volume of manufactured

Third quarter:	Percentage decline in the volume of United Kingdom manufactured exports	Percentage decline in the volume of United Kingdom raw-material imports
1929 to 1930	— 24%	— 12.5%
1937 to 1938	— 16%	— 14%

exports fell more heavily than between 1937 and 1938, whereas the volume of raw-material imports fell less in the earlier than in the later period. It appears that, in the earlier period, the demand for manufactured exports fell severely, as a result of the depression in world markets, and that the demand for imported raw materials was maintained to some extent by the comparative stability of internal activity. In the more recent period, the decline in the external demand for British manufactured goods was more moderate, whereas the fall in internal activity caused a sharper decline of imported raw materials.

But in spite of the fact that a slump was to be expected in the United Kingdom and that internal conditions, rather than the repercussions of depression in other countries, were likely to prolong it, the recession was arrested in the course of 1938. In the United States, the economic outlook was reversed during 1938 by the change of monetary and budgetary policy, which has been examined above. In the United Kingdom, the outlook has been equally affected by the problems of rearmament. Between 1936 and 1938, increasingly large sums were spent on armaments, as the following figures show:

United Kingdom: Defence Expenditure, including Sums borrowed.¹

	£ (000,000's).				
	1935	1936	1937	1938	1939
First quarter . . . . .	.	41.8	59.4	89.3	127.5
Second quarter	27.5	37.5	46.3	65.8	123.9
Third quarter	30.3	41.2	58.3	86.4	...
Fourth quarter	37.3	48.0	68.3	102.9	...

between the middle of 1937 and the middle of 1938. Cf. *The Economist*, May 6th, 1939, page 296.

¹ *The Economist*, January 17th, 1939, page 8, and July 8th, 1939, page 63.

Not only have the sums spent on rearmament increased rapidly, but also the method of financing these sums has been greatly changed in recent months. In the first half of 1937, the recovery from the great depression was still continuing; a speculative boom in commodities had developed; and activity was at a comparatively high level. During 1938, the pound was depreciating in value in terms of the dollar and of other currencies, both because of capital exports from the United Kingdom and because of some strain on the current items in the United Kingdom's balance of payments.¹ In both these years, therefore, it appeared appropriate to finance the greater part of rearmament by taxation rather than by borrowing. For taxation might be expected to curtail private expenditure *pari passu* with the expansion of Government demands; and in 1937 this helped to diminish the intensity of the speculative commodity boom, and in 1938 to diminish the pressure upon the pound in the foreign exchanges.

But, by the beginning of 1939, economic activity was considerably reduced; the pound had fallen to a lower value in the exchange market; and the main bulk of the foreign liquid funds in London had already been removed. As the following figures show, the changed conditions have been accompanied by a substantial change in the method of financing rearmament expenditure:

*United Kingdom: Defence Expenditure financed from
Revenue and from Borrowing.*

	£ (000,000's).	1937/38	1938/39	1939/40 (estimate)
Defence expenditure financed from revenue		201	272	248 ²
Defence expenditure financed from borrowing		65	128	380 ²
		<hr style="width: 50%; margin: 0 auto;"/>	<hr style="width: 50%; margin: 0 auto;"/>	<hr style="width: 50%; margin: 0 auto;"/>
Total defence expenditure		266	400	628 ²

For 1939/40, total defence expenditure is expected to rise by as much as £228 million; but the total to be financed from tax revenue is to be reduced by £24 million and defence borrowing is to be increased by as much as £252 million.

There is evidence that in 1938 rearmament expenditure was already an important factor maintaining activity in a number of industries. Thus, during the year, unemployment in shipbuilding actually fell by 2%, although the tonnage of merchant vessels under construction fell by as much as 33¹/₂%.

¹ Cf. Chapter VII.

² Cf. Chapter IX for further increases in these figures, announced in July 1939.

Unemployment also fell by 2% in the group of industries comprising the production of motor vehicles, cycles and aircraft, although there was a considerable decline in the production of motor-cars. Rearmament demands had proved of great importance in these industries. On the other hand, in many industries, in which Government demands were not directly of importance, unemployment rose considerably — in textiles, for example, by 30% and in coal-mining by 18%.¹

Increased expenditure on rearmament in the United Kingdom is as important as the new "pump-priming" expenditure in the United States. The £380² million which it is planned to borrow for rearmament expenditure in the United Kingdom in the financial year 1939/40 represents some 7.6% of the United Kingdom national income, estimated at £5,000 million for 1938; whereas the total "pump-priming" expenditure of \$3,753 million which was started in the United States in the middle of 1938 represents no more than 5.9% of the national income of the United States, estimated at \$63,993 million for 1938. A net Government deficit, which entails borrowing for expenditure on civil works, relief or armaments, is — in its immediate effects upon economic activity — in many ways similar to borrowing on the part of private enterprise for expenditure on capital construction. The following figures³ illustrate recent changes in the total of such borrowing by private enterprise for investment and by the Government for rearmament in the United Kingdom:

	Private investment	Government deficit, minus surplus of the Unemployment Insurance Fund	Total: Private investment, plus net Government deficit
	£ (000,000's)		
1937/38	824	5	829
1938/39	670	129	799
1939/40 (estimate) . .	680	355	1,035

It has been suggested that these changes have completely changed the economic outlook in the United Kingdom.⁴ The total of private investment and of the Government deficit may be expected to rise by more than £200 million in 1939/40, according to the foregoing figures. Such an increase in expen-

¹ Cf. *The Times*, Annual Financial and Commercial Review, February 7th, 1939, page XVI.

² Raised to £500 million in July 1939, cf. Chapter IX.

³ Cf. *The Financial News*, Banking, Insurance and Financial Review, April 3rd, 1939, page 3. The estimates for 1939/40 are based upon the assumptions that private investment continues at the same level as in the last quarter of 1938/39, that £380 million are borrowed by the Government for rearmament expenditure, and that increased industrial employment raises the surplus of the Unemployment Insurance Fund to £25 million.

⁴ Cf. *Financial News*, loc. cit., and two articles by Mr. J. M. KEYNES in *The Times*, April 17th and 18th, 1939.

diture will stimulate the demand for additional goods and services, as wages, profits and other incomes rise. There is some evidence that, if there is a sufficient volume of suitable unemployed resources, an expenditure of £200 million of this kind may rise the national income by approximately double that sum. Since the value of a man's output in the United Kingdom is approximately £250 per annum, this increase in activity would give employment to some 1,500,000 additional workers. At February 1939, there were approximately 1,800,000 registered unemployed; and when allowance has been made for the facts that the geographical and industrial transfer of workers raise very difficult problems and that a number of the older unemployed who have been without work for a long period can with difficulty be reabsorbed into industry, it is apparent that considerable scarcities of labour may develop, even if hours of work are extended. Unless private expenditure on consumption or on investment is reduced by taxation or by Government regulation, the very high level of industrial activity which such a development would represent is likely to cause serious problems both in the labour market and in the finance of imports, which will be considerably stimulated.

FRANCE

During 1938, the underlying economic conditions in France improved substantially. This was true, in spite of the fact, which can be seen from the graph on page 12, that there was little recovery of production before 1939; but many of the obstacles to recovery, both in external and in internal economic conditions, were removed during 1938, so that prospects for a future increase in production were better at the close of 1938 than they had been for many years.

Since 1936, when the forty-hour week was first introduced and the franc was devalued, two closely related economic problems have dominated the French economy. Internally, as can be seen from the graph on page 12, there has been a very sharp rise in hourly money wage rates between 1936 and 1937, which was largely caused by the reduction of hours of work with upward adjustments of the hourly money wage rates to maintain workers' earnings. This rise in wage costs had been accompanied by a comparable rise in commodity prices. This gave rise to an increased demand for money and for credit to finance the business turnover, which had risen in money value as a result of the large rise in prices and costs. In spite of a moderate increase in the supply, this increased demand for credit caused interest rates to be maintained at very high levels, and so made it difficult to borrow money for

capital developments. One necessary condition for a rehabilitation of the French economy was a reduction of interest rates and an easing of internal monetary conditions.

These developments had also caused grave external difficulties. The continual rise in internal costs and prices reduced exports and encouraged imports. This alone exerted a considerable pressure upon the franc in the foreign exchange market, and was an important reason of its continual depreciation between September 1936 and May 1938.¹ But this decline in the value of the franc led to speculation that the depreciation would be still further continued; and for this reason, large sums of capital were continually exported during this period. The fall in the value of the franc was itself, in turn, much accentuated by this purchase of foreign currencies for the finance of capital exports. The flight of capital also led to large losses of gold by the Bank of France, and this was one of the main reasons causing a relative scarcity of credit facilities within the country. It was thus an important factor preventing the recovery of internal economic activity. The exchange value of the franc fell from 76 francs to the pound in August 1936 to 178 francs to the pound in June 1938. An arrest of this process was the second main condition for a recovery in France.

As the graph on page 12 shows, the precipitous rise of wage rates and prices was stopped in the course of 1938. Largely as a result of this, it was possible to set an upper limit of exchange depreciation at 179 francs to the pound in May 1938, and this limit has been successfully maintained. Immediately after this decision, there was some considerable return of capital to France; and although international political difficulties in the subsequent months caused a large part of this capital to be re-exported, there was a steady inflow of capital again after the initiation of financial reforms by M. Reynaud in November 1938, to which reference is made below. The stabilisation of the franc at a level which removed all overvaluation of the currency, in the absence of any substantial further rises in wage rates and prices, has greatly improved the balance of French trade, as the following figures show:

Value of French Imports and Exports by Quarters.

	1937				1938				1939
	I	II	III	IV	I	II	III	IV	I
Imports . . .	10,227	10,055	9,861	12,226	11,699	11,566	10,744	11,963	12,489
Exports . . .	5,305	5,729	5,804	7,106	6,979	6,979	7,425	9,181	8,736
Excess of imports .	4,922	4,326	4,057	5,120	4,720	4,587	3,319	2,782	3,753

¹ Cf. Chapter VII.

During 1938, there has been a substantial increase in the supply of money, as can be seen from the graph on page 12. In previous years, the expansive effect of Government borrowing of new funds from the Bank of France had been largely offset by the export of capital. But in 1938, the repatriation of exported capital accentuated the expansive effect of new borrowing from the Bank of France.¹ The following table illustrates the combined effect of these changes upon the cost of borrowing:

Changes in French Monetary Conditions.

	Percentage increase (+) or decrease (—) during the years:		
	1936	1937	1938
Total supply of money ^a	+ 8	+ 5	+ 16
Wholesale prices	+ 46.5	+ 21.5	+ 8
Hourly wage rates	+ 30	+ 40	+ 8
Yield on Government bonds ^b	+ 2	+ 23	— 22

^a See footnote to graph on page 12.

^b Yield on 4% 1918 Government bonds.

As has already been seen, the rapid increases in money wage costs and prices which occurred during 1936 and 1937 prevented the moderate increase in the supply of money from leading to any reduction in the high costs of borrowing. During 1938, a more substantial increase in the supply of money, together with only moderate rises in prices and costs, restored monetary liquidity and brought about a reduction of interest rates.

As the graph on page 12 shows, the reduction of interest rates was most marked at the end of 1938, as a result of the financial and other reforms initiated by M. Reynaud in November of that year. Short-term interest rates also fell considerably and the discount rate of the Bank of France was reduced from 3% in October to 2.5% in November 1938 and to 2% in January 1939. Perhaps most significant of all was the raising of a long-term loan in the Netherlands and Switzerland in January 1939 at the comparatively low interest rate of 4% for the purpose of converting 3,600 million francs of railway loans. This improvement in monetary conditions has been very marked; but, as the following figures show, it has still a long way to go before the French economy can benefit from a policy of cheap money to the same extent as other important industrialised countries.

¹ Cf. Chapter III.

Yield on Government Bonds in the Last Quarter of 1938.*

(1929 = 100.)

France	United States	United Kingdom	Germany	Japan
92	69	77	63	75

* *France*: Rente 3%. *United States*: Ten Treasury bonds. *United Kingdom*: 2½% Consols. *Germany*: 4½% public bonds. *Japan*: Eight Government bonds.

The related problems of the depreciation of the franc, of the excessive rise of internal prices and costs and of the high cost of borrowing have been largely overcome as a result of the measures discussed above. But the continued tension in international political relations has led to great increases in expenditure on rearmament; and this development has hampered the solution of the French budgetary problem, in spite of strenuous efforts to increase revenue and to impose economies in other forms of expenditure.¹ In May and November 1938 and again in April 1939, taxes, both direct and indirect, were raised and substantial economies on civil expenditure were achieved. But the rise of expenditure on national defence from 13,083 million francs in 1935 to an estimated figure of 46,032 million francs in 1939 has prevented any reduction of the State deficit, as the following figures show:

France: Excess of State Expenditure over Revenue.*

Francs (000,000's).

1936	1937	1938	1939
17,112	20,825	14,195	28,212

* Expenditure includes the "Fonds d'armement, d'outillage et d'avances sur travaux" and the "Compte des investissements en capital".

The improvement in the French economy was most marked in the last months of 1938. In November, a number of important financial and economic measures were taken as a result of a report by M. Daladier and M. Reynaud.² In addition to the imposition of additional taxes and of economies on civil expenditure, which constituted a large part of their report and which is discussed in the next chapter, a number of other important reforms were initiated. In essence, these reforms were intended to restore the conditions in which a liberal economy might be able to function profitably and efficiently. It was announced that a policy of easy money would be adopted; and, as has already

¹ This problem is discussed in more detail in the next chapter.

² Cf. *Journal officiel*, November 12th, 1938.

been seen, this policy, aided by the repatriation of exported capital and by the stabilisation of the franc at a level which removed the complications of an overvalued currency, has been largely successful. The gold reserves of the Bank of France were to be revalued at a higher price in francs, which corresponded more closely to the existing gold value of the franc; and the profit of 31,456 million francs from this revaluation was used for the reduction of the existing advances of the Bank of France to the Treasury. At the same time, the permanent item of advances of the Bank of France to the Treasury was raised by some 7,000 million francs. This sum, together with the existing Treasury balances and with Government borrowing on short term, was to be used to finance the public deficit, so that for some months the Government would not compete with private enterprise in borrowing funds on the long-term capital market. The incentive to private borrowing for capital development, provided by the reduction of interest rates and by the absence of Government borrowing on long term, was accentuated by the modification of a number of taxes which weighed heavily upon private capital construction.¹

At the same time, the French economy was released from certain restrictive controls. The system of price controls, which had hampered private enterprise, was to be liberalised; and the forty-hour week was modified by the abolition of the five-day week and by the right of employers to call for overtime at non-prohibitive rates of overtime pay. This lengthening of hours of work, particularly in the industries working for national defence, was further extended by additional decrees in the first months of 1939.²

As the following figures show, the low level of French production has been associated with a comparatively moderate degree of unemployment:

Production and Unemployment in France, the United States and the United Kingdom.

	France		United States		United Kingdom	
	1937	1938	1937	1938	1937	1938
Industrial production, (1929 = 100) . . .	83	77	92	72	124	116
Percentage of workers unemployed ^a . . . .	.	8	13	20	11	13

^a *France*: Estimate taken from the report of M. Daladier and M. Reynaud, *Journal officiel*, November 12th, 1938; includes wholly and partially unemployed. *United States*: National Industrial Conference Board index. *United Kingdom*: Ministry of Labour; includes wholly and partially unemployed.

¹ Cf. Chapter II.
² Cf. Chapter V.

Although production in France in 1938 was some 23% below the 1929 level, only 8% of the workers were unemployed, whereas in the United Kingdom, during the high level of economic activity of 1937, as many as 11% of the workers were unemployed.

At the end of 1938, conditions were favourable for a recovery of production in France on the lines of a liberal and comparatively unregulated economy. But the outlook was dominated by increasing international tension, by the consequent increases of rearmament expenditure, and by the possibility that, in such conditions, some of the principles of a liberal economic system might need to be sacrificed for military purposes.

GERMANY

German economic activity experienced no setback during 1938. As can be seen from the graph on page 12, the expansion of production and employment proceeded at a lower rate than in previous years, since virtually full employment of all resources of men, capital and raw materials had been achieved by 1937; and further expansion was possible only by extending hours of work, by improvements in technique and by absorbing into industrial employment certain additional sources of labour, such as women, handicraft workers and older persons who would otherwise have retired. The number of registered unemployed has been reduced from an average of 5,575,000 in 1932 to an average of 429,000 in 1938, with the result that a real scarcity of labour, as well as of capital and raw materials, has appeared in many occupations.

This situation has been brought about primarily by the very high level of State expenditure upon public works, including the construction of a network of motor-roads, upon rearmament, and upon State-controlled capital investment for the prosecution of the four-year plan, which is designed to make Germany as self-sufficient as possible through the production of synthetic raw materials and the exploitation of low-grade internal sources of supplies. But, in part, the scarcity of labour is to be explained by the conscription of men for the expansion of the armed forces and for the formation of the Labour Corps, whose members are counted neither among the employed nor among the unemployed.

From the graph on page 12, it can be seen that the recession of trade activity in other countries during 1937 had no appreciable effect upon the other indices of German internal economic activity. Commodity prices and money wage rates remained stable in consequence of the continuation of the policies of price

and wage control to which reference will be made below. The rate of interest continued at a low level; and there was a considerable increase in the supply of money, a large part of which must be attributed to the greater issue of German currency as a result of the territorial expansion of the German Reich.¹ On the other hand, security prices showed an appreciable decline since the middle of 1937; but there are a number of special factors which explain this decline. The realisation of Jewish property exercised some selling pressure upon the Stock Exchange; and some sales of property for ready money occurred in consequence of a scarcity of liquid funds, which resulted from the changed method of financing Government expenditure. Reference will be made to this in a later section of this chapter.² Certain other developments tended to reduce the profitability of industry.³ There was a substantial increase in the tax on corporation profits, to which reference is made in the next chapter. Production had reached capacity and costs of production rose to some extent also through the deterioration in the quality of the additional labour employed; the increased use of home-produced substitute raw materials in some cases raised costs; and the necessity for paying overtime wages, bonuses and separation allowances raised labour costs, in spite of the fact that the normal money wage rate was stabilised. While costs rose for these reasons, selling prices were prevented from rising through strict control.

The recession in world economic activity in 1938 affected the German economy directly only through the reduced demand for German exports. As the following figures show, there was a considerable reduction in the value of German exports after the end of 1937:

Value of German Imports and Exports by Quarters.

RM. (000,000's).

	1937				1938				1939
	I	II	III	IV	I	II	III	IV	I
Imports	1,093	1,434	1,443	1,499	1,383	1,316	1,324	1,426	1,289
Exports	1,285	1,431	1,566	1,629	1,339	1,262	1,280	1,376	1,262
Excess of exports (+) or of im- ports (—) . . .	+ 192	— 3	+ 123	+ 130	— 44	— 54	— 44	— 50	— 27

¹ Cf. Chapter III.

² For a fuller discussion, cf. Chapter III.

³ Cf. Reichskreditgesellschaft: "Germany's Economic Position at the Turn of 1938/39".

As a result of this development, an excess of imports developed during 1938, which was financed in large part by the use of the gold and foreign exchange reserves which resulted from the incorporation of Austria in the Reich. But the position was not essentially unfavourable to Germany; for, as is usual during a period of world recession, the prices of the raw materials which Germany imports fell much more rapidly than the price of her manufactured exports; and it has been estimated that the ratio between the prices paid for imports and those received for exports moved some 12% in Germany's favour.¹

The outstanding internal problem of the German economy in 1938 was the finance and organisation of the heavy Government expenditure on armaments and investment for the carrying-out of the four-year plan. From 1933, recovery of production and employment in Germany had been brought about by heavy Governmental expenditure, financed largely by credit creation through the issue of special bills which could be rediscounted by the Reichsbank. This expansive policy was successful in absorbing the unemployed resources of the community and in stimulating trade activity. As Germany has not devalued the mark, this internal expansion has been accompanied by a policy of foreign exchange and import control, in order to resist the pressure upon the mark which the rising demand for imports entailed. But in more recent years, the nature of the German experiment has changed. For by 1937 virtually full employment of the existing resources of men, materials and capital had been achieved;² but, at the same time, it was desired still further to increase the expenditure of the State upon armaments and public investment under the four-year plan. In the most recent years, there has therefore been a double problem: first, to raise the money necessary to finance the expansion of public expenditure; and, secondly, to prevent this expansion from stimulating private demand for domestic goods, or for imports, and to drain economic resources from private to public employment.

The figures on page 34 illustrate this problem. It will be seen that, in 1936, real income per head in Germany had recovered approximately to its 1929 level,³ and it is therefore of

¹ Cf. Reichskreditgesellschaft: "Germany's Economic Position at the Turn of 1938/39".

² Recent territorial expansion of the Reich has added some unused resources of men and capital to the German economy. The economic problems raised by these territorial changes are discussed in Chapter IX.

³ It is possible that the recovery of real income per head is somewhat exaggerated by these figures. For the price index of cost of living, by means of which the money income figures are converted into real income figures, may not make full allowance for the rise in the cost of living. It does not allow for any deterioration in the quality of such goods as clothing, which may have resulted from the use of substitute raw materials; and, like all price indices, it is based upon the prices of those standard types of goods and services over which price control is probably most successful.

interest to compare these two years. It might be expected that, as income per head in these two years was the same, approximately equivalent proportions of the national income would normally have been allocated to savings, to taxation, to consumption and to imports. But, as the figures show, Government intervention had appreciably raised the proportions of income raised in taxation or allocated to the finance of capital investment, and had reduced the proportions spent upon imports and upon retail purchases for consumption.

Germany: National Income and Public Investment.

	1929	1936	1937	1938
Real national income ^a per head (1929 = 100)	100	100.5	108	...
Total investment as percentage of national income ^b	16.9	21.3	22.5	24.3 ^c
Public investment as a percent- age of total investment ^b	35.2	55.1	56.3	...
Total taxes as a percentage of national income	19.0	24.0	26.2	28.9 ^c
Imports as a percentage of national income	17.6	6.5	7.7	7.2 ^d
Retail trade turnover as a per- centage of national income	48.2	42.8	43.5	44.7 ^c

- ^a National income per head at 1928 prices.
- ^b Gross investment.
- ^c Preliminary figures.
- ^d Preliminary figure, excluding trade with Austria.

The rise in the ratio of total investment to the national income from 16.9% to 21.3% between 1929 and 1936 underestimates the extent of the change. For in 1929, unlike 1936, a considerable part of total investment was still being financed by funds borrowed from abroad, so that the proportion of the German national income which must be saved to finance investment has risen more sharply than is indicated by these figures.

The above table also shows the effect of the Government measures which restrict private investment to the benefit of public construction. Public investment rose from 35% to 55% of total investment activity between 1929 and 1936. The same change is illustrated by the following figures for two different aspects of activity in capital construction:

Germany: Public and Private Investment Activity.

	1929	1936	1937	1938
Proportion of public capital issues to total net domestic issues	% 19.5	% 83	% 83	% 90
Proportion of public expenditure upon building to total expenditure on building ¹ .	33	60	61	66

Indeed, the building trades in recent years have been so much concentrated upon State projects that, during the years of rapid economic recovery between 1933 and 1937, the deficiency of private dwellings has increased from 1,000,000 to 1,500,000.² Largely as a result of the building of military fortifications, the number of new dwellings completed fell by 15% between 1937 and 1938.

In order to achieve these shifts in the economy, a number of Government controls have been introduced. It has been necessary to introduce a rigid control over foreign trade, to restrict imports and to encourage exports to pay for the essential minimum of imported commodities. In order to raise funds to finance part of the State expenditure and in order, at the same time, to restrict private expenditure, rates of taxation have been maintained at the crisis levels of 1933 or have been still further raised, in spite of the large rise in taxable income. The whole economic system is, moreover, based upon the control and rationing of the available resources of men, raw materials and capital among the various possible uses, so that preference may be directly given to public projects. A recent change in the control of the labour market has enabled the Government to conscript labour, if necessary, for works of public importance. The rationing of raw materials is based upon the control of raw-material imports by the various import control boards, and provides a very effective method of giving priorities to work for the State or for the export market. There are also a variety of methods by which private capital construction is restricted. The establishment of new companies and the extension of plant and building in all important branches of industry are prohibited, except with Government permission; and the renewal of plant, which was subsidised in the first years of the National-Socialist Government, when excessive unemployment made all such capital expenditure desirable, is now no longer exempt from taxation.

¹ Cf. Reichskreditgesellschaft. Deutschlands wirtschaftliche Lage in der Jahresmitte 1939.

² Cf. *Deutsche Volkswirt*, December 23rd, 1938, page 580.

Except in a few cases such as butter, the sale of consumption goods to the consumer has not been directly rationed; but there have been increased quantitative restrictions of the supply of such commodities. It might be expected that strict rationing of consumption goods would become necessary; for in spite of the absence of further reserves of unemployed resources, the heavy Government expenditure is still financed to a large extent by means of credit creation, and the prices of consumption goods have been prevented from rising by price regulation. But the need for the rationing of consumption goods has been much reduced by the many measures taken to prevent any large part of the increased income from being spent on consumption. Increased rates of taxation have already been mentioned as one such measure. Wages are prevented from rising by a system of wage control; in the middle of 1938, a decree was issued to strengthen this control by entrusting the Labour Trustees with the supervision of all wage conditions, in order to prevent concealed increases of wage rates. Dividend payments are strictly limited by recent heavy increases in the taxation of corporation profits and by the prohibition of the payment to shareholders of a dividend above 8%. Companies being unable to raise wage rates or dividends payments are forced to save their excess receipts, if they cannot obtain larger allotments of labour and raw materials to expand their production. The restriction of expenditure on consumption is also accentuated by a number of other policies. There is a campaign for individual savings, to promote which the network of Austrian Postal Savings Banks was extended throughout the Reich after the incorporation of Austria; contributions and levies for various party purposes also diminish expenditure upon consumption; some of the measures against the Jews have diminished the buying power of that class of the population; and the Aryanisation of Jewish property has encouraged saving on the part of the purchasers of former Jewish property.

In the main, the German economy developed during 1938 on lines which had already been laid down in previous years. The most striking change was in the method of raising the funds for the finance of extraordinary public expenditure.¹ Up to March 1938, the main method of such finance had been through credit expansion by means of the issue of special bills, which were a very liquid means of payment, since they could be rediscounted with the Reichsbank; and this method of finance was accompanied by the issue from time to time of substantial

¹ Cf. Chapter III.

long-term Government loans. In March 1938, it was decided that this method should give place to a finance which was more appropriate to an economic situation in which there were virtually no more unemployed resources to be absorbed through further credit creation. For a transitional period of six months, special "delivery bills" which could not be rediscounted at the Reichsbank were to be issued, but they were to be limited to the amount which could then be redeemed by the proceeds of taxes and long-term Government loans during the following half-year. This system did not achieve its object. Delivery bills were issued in excess of this quantity, largely as a result of the subsequent expenditure on military mobilisation and the construction of fortifications.

At the beginning of March 1939, a new system was announced. Public authorities were to finance 40% of their purchases by tax certificates of two classes, one of which would be accepted in payment of Reich taxes and dues six months after their issue, and the second of which would be accepted in payment of such taxes some three years after their issue and which would earn interest at approximately 4% per annum. In turn, the contractors who receive payment in this form can pay for 40% of their purchases with the tax certificates which they have received. At the same time, it was announced that Reich loans would be issued only in exceptional circumstances. In order to induce persons to hold the short-dated certificates for longer periods, special tax benefits were announced for those who were willing to do so. The inflationary effects which might be expected to result from such a method of finance are held in check by the various Government controls over the system, which have been discussed above. Since payments to consumers of wages and dividends are strictly limited, and since private expenditure on capital goods, raw materials and labour are also rigidly restricted, the uses to which the receipts of income in the form of tax certificates — or, indeed, in any other form — can be put are narrowly constricted; and the certificates must therefore be held in the economic system, in the absence of alternative outlets for their disposal.

JAPAN

Economic developments in Japan during 1938 were dominated by the prosecution of the Chinese war, and in many respects resembled the problems experienced in Germany. Practically full employment of resources had been achieved;

but, in spite of this, the heavy Government expenditure was financed by methods which involved a substantial monetary expansion, as is evident from the graph on page 13. This policy prevented the world recession in 1938 from affecting the high level of internal economic activity. For, as can be seen from the graph, employment continued to expand; and although production ceased its rapid rise as a result of the absence of any further reserves of unused resources, it nevertheless showed no decline. Security prices alone showed a marked fall. In order to prevent the monetary expansion from causing an inflationary rise of prices, and in order to drain economic resources from peace-time uses to production for the prosecution of the war, various Government controls were introduced or strengthened in the course of the year.

The problem of the Japanese war economy had two main aspects: externally, the finance of essential commodity imports and, internally, the finance of Government expenditure and the regulation of production for war purposes. A severe strain on the finance of commodity imports developed for a number of reasons. The demand of war industries for raw-material imports was heavy; the recession in world trade, together with unofficial boycotts on Japanese goods, reduced the receipts from exports; and various other receipts from invisible exports, such as shipping and tourist traffic, were seriously reduced.¹ This difficulty was met in large measure by a strict control of imports, which was intensified during the year. For example, even the imports of such important commodities as wood-pulp, timber and crude rubber for the first quarter of 1939 were reduced to 90% of such imports for the preceding quarter. The following figures show how imports, which had been peculiarly heavy during the first half of 1937 before the outbreak of the war, were severely reduced, even below the diminished level of exports:

Value of Japanese Imports and Exports by Quarters.

	Yen (000,000's).								1939
	1937				1938				
	I	II	III	IV	I	II	III	IV	I
Imports .	992	1,122	913	706	620	763	591	669	696
Exports .	686	810	812	816	565	624	673	806	620
Excess of exports (+) or of im- ports (-)	-306	-312	-101	+110	-55	-139	+82	+137	-76

¹ It is estimated that receipts from tourist traffic were reduced by 60%. Cf. *Commerce Reports*, February 25th, 1939.

These figures do not fully indicate the strain which was put upon the Japanese foreign exchanges. For the exports to the *bloc* of countries with the regulated yen currency increased at the expense of exports to other countries; and, for this reason, the ability of Japan to purchase essential materials in the free world markets was much reduced, as the following figures¹ show:

Percentage Change in Imports and Exports of Japanese Empire during 1938.

	Exports to %	Imports from %
All countries	— 13	— 28.5
Countries of the yen <i>bloc</i>	+ 47	+ 26
Other countries	— 38	— 40

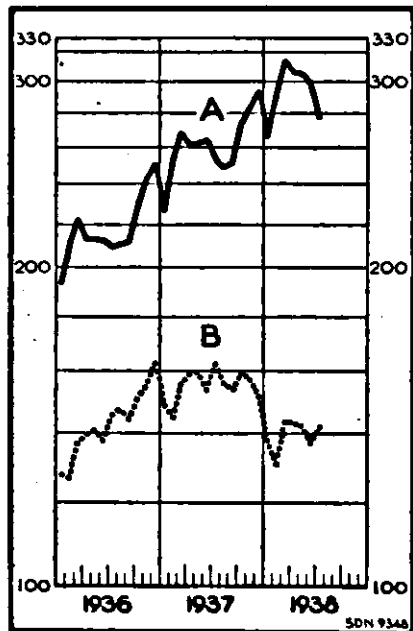
In addition to the direct control of imports, various other measures were taken to prevent the strain on the foreign exchanges from causing a depreciation of the yen. The system of exchange control, which had already been imposed in 1937, was strengthened during 1938; there were heavy exports of gold; and a system was instituted to link the import of raw materials with the export of manufactured goods, and for this purpose raw materials were divided into those used for the production of exports and those for domestic consumption, so that the latter could be severely reduced.

The domination of the internal economic system by the exigences of the war is most clearly illustrated by the changes in the production of consumption goods and of capital goods. As the accompanying graph shows, the production of invest-

Japan: Production of Consumption Goods and of Investment Goods.

(1930 = 100.)

- A Production of investment goods.
- B Production of consumption goods.



¹ Cf. *Commerce Reports*, February 25th, 1939.

ment goods, which include the instruments of war, continued to expand rapidly, whereas the production of consumption goods was considerably reduced. With practically full employment, the expansion of the armed forces and of the production of armaments could expand only at the cost of consumption.

The internal financial problems which have been raised by these developments are discussed at length in the two following chapters. In Chapter II, reference is made to the very large sums which have been expended by the State on the armed forces, which for 1938 appear to have represented as much as 76% of State expenditure and 30% of the total national income.¹ It will be seen in Chapter III that the greater part of these funds have been raised by the sale of Government bonds to the banks; and this has caused a large expansion in the total supply of money, which is illustrated in the graph on page 13.

This increase of monetary supplies has not been accompanied by an equivalent rise in prices; and production has remained practically constant as a result of the full employment of resources, as the following figures show:

Japan: Changes in Production, Prices and the Supply of Money between the Third Quarters of 1937 and 1938.

	%
Supply of money	+ 18
Wholesale prices	+ 6
Cost of living	+ 12
Industrial production	- 0.5

To prevent this inflationary method of finance from leading to too rapid a rise in prices and in order to restrict activity in non-essential branches of the economy, various internal controls have been imposed. In the middle of 1938, the system of price control was much extended by a general regulation to prevent prices from rising above the mid-1938 level. Central and local price commissioners have been appointed with a special police to enforce observance of the regulation. In order to ensure adequate supplies of labour for essential occupations, regulation of the labour market has been extended. For example, through the application of the General Mobilisation Law, a system of compulsory regulation was started for workers in key industries; and the training of students for technical work has been regulated in such a way that the period of their academic studies may be shortened.

¹ Cf. page 59.

As has been mentioned above, raw-material supplies have been strictly rationed; and the amount of raw cotton, for example, which may be obtained for manufacture for the domestic market is severely restricted. Limitations have been placed upon the domestic consumption of rayon and upon exports of rayon to Manchuria and China, where free foreign exchange cannot be obtained from the sales of Japanese exports. In order to divert capital resources to industries which are essential for the prosecution of the war, capital issues for the extension of plant have been placed under Government control; and this restriction was strengthened in September 1938.

Measures have also been taken to reduce expenditure upon consumption. As will be seen in the next chapter, there have been some relatively unimportant increases in taxation. At the same time, a vigorous savings campaign has been launched; and, in some cases, it has been made compulsory to save some part of income. Government bonds have been sold in exceptionally low denominations, to enable small savings to be invested in them. A recent application of the General Mobilisation Law provides for the limitation of dividend payments, which will restrict expenditure out of profits. As in Germany, an inflationary method of finance of Government expenditure has been combined with a control of prices and with a system which directly rations the supplies of raw materials, labour and capital resources to producers. It is probable that in these circumstances there is an almost automatic increase in savings, since people are severely restricted in the choice of alternative outlets for their income. This has enabled the Government to sell a certain proportion of the issue of Government bonds to private individuals, although the greater part has been placed with the banks in return for the creation of new deposit money.

IMPORTS AND EXPORTS OF COUNTRIES PRODUCING PRIMARY PRODUCTS

The countries which depend mainly upon the production of primary commodities were seriously affected by the recession of business activity which occurred in many of the industrialised countries between the middle of 1937 and the middle of 1938. These countries are peculiarly dependent upon their export trade; and, in periods of world recession, their exports are severely reduced by the fall in demand for raw materials on the part of their industrialised customers. Their position is aggravated by the fact that the prices, as well as the quantities,

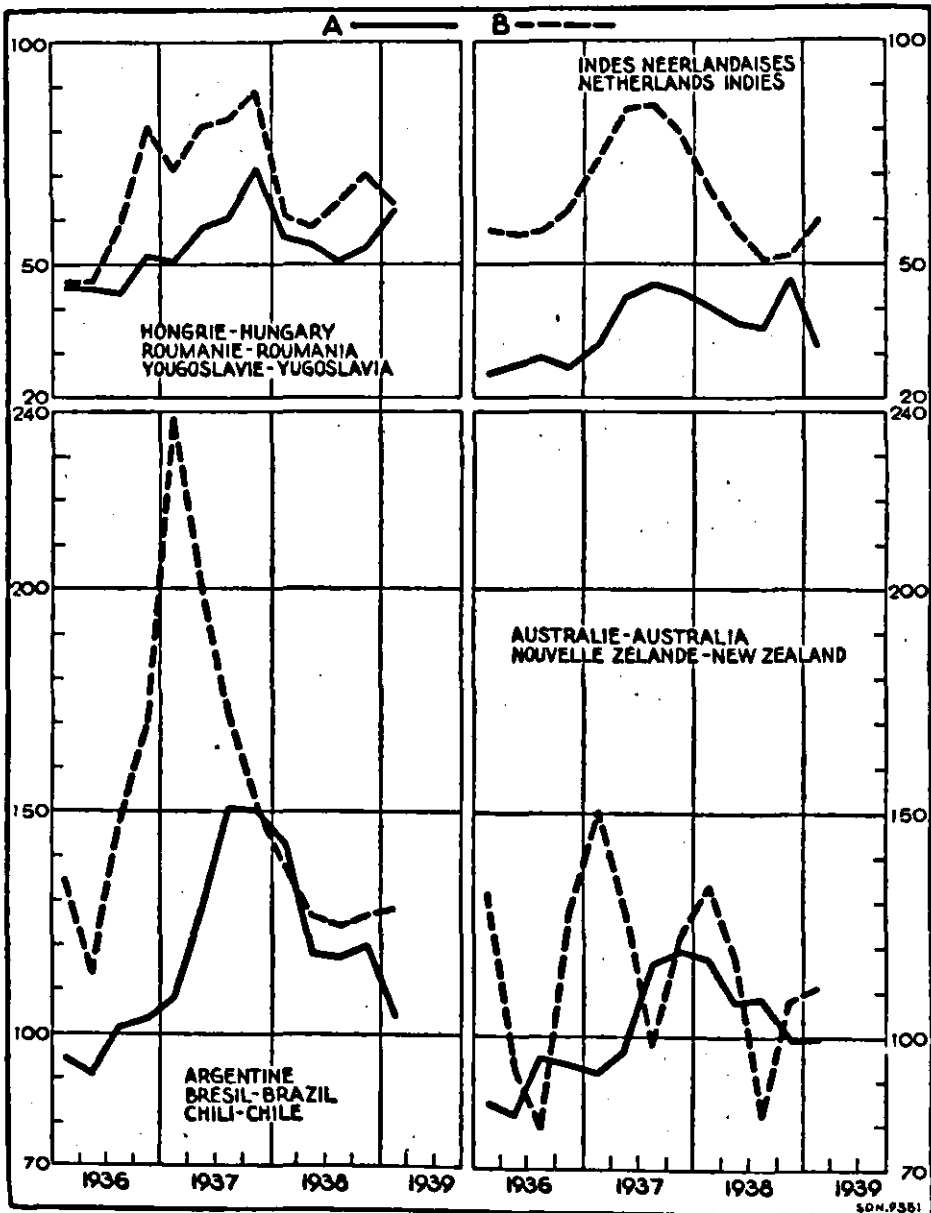
of their exports decline seriously, whereas the prices of the manufactured goods which they purchase generally fall by a comparatively small amount.

Foreign Trade of Certain Primary Producing Countries.

Old gold \$ (000,000's).

A Value of imports.

B Value of exports.



On page 15 above, figures were given to illustrate the particularly rapid fall in the demand for imports which took place in the United States, which provides a most important market for many raw materials. The graph on page 42 illustrates the effect of this recession upon the foreign trade of four groups of countries which produce primary products. In each case, the value of exports in 1938 was considerably lower than in 1937. The graph also illustrates two further characteristics of the foreign trade of countries of this type in a period of depression. In the first place, in each of the four groups of countries, the value of exports fell considerably more than the value of imports; and this is largely due to the fact that the price of their exportable primary products fell much more than that of the manufactured commodities which they purchase. In the second place, the fall in the purchases of imports by countries producing primary products usually lags behind the fall in their receipts of income from exports. This phenomenon was particularly marked during 1937 and 1938 in the case of the countries of Australasia and of South America, where imports continued to increase for some time after the decline in their exports. It was not, however, apparent in the group of agricultural countries of South-East Europe, whose imports are linked more closely to their exports through clearing agreements and similar measures of trade control.

For these reasons, the balance of trade of these countries became less favourable after the middle of 1937, and this imposed a considerable strain upon their foreign exchanges. The majority of agricultural countries met this pressure by allowing their currencies to depreciate or by imposing or strengthening measures of exchange control; and, in consequence, they hindered an outflow of gold or of foreign exchange reserves. On the other hand, a certain number, such as the Argentine, Australia, New Zealand, India and Ecuador, lost considerable amounts of their gold or foreign exchange reserves. But in these countries, as will be seen in Chapter III, measures were taken to offset these movements of monetary reserves, so that the internal deflation which would otherwise have followed was mitigated or entirely prevented. By such means, internal economic activity, although it was directly reduced by the fall in income from exports, was not subjected to any cumulative process of deflationary depression; and in Australia and New Zealand, for example, internal industrial activity was maintained at a comparatively high level.

The recovery of economic activity in the United States and in a number of other industrialised countries since the middle of 1938 has already altered the outlook in the countries

producing primary commodities. It has been shown on page 15 that the American demand for imports had already recovered some part of its decline by the end of 1938; and the graph on page 42 shows that the exports of the primary producing countries had ceased to decline, and in some cases had risen rather more than seasonally, by the last quarter of the year. The continuation of recovery in the industrialised countries would accentuate this movement; and, after a certain time-lag, it would lead to a revival in the imports of manufactures by the agricultural countries.

Chapter II

PUBLIC FINANCE AND NATIONAL INCOME

NATIONAL INCOME AND THE BALANCE OF STATE REVENUE AND EXPENDITURE

During the great depression, the subsequent recovery of trade and the present period of crushing expenditure on armaments, no feature of economic life has been more affected than public finance. The graphs on pages 46 and 47 illustrate for a number of countries the changes which have occurred since 1929 in State revenue and expenditure. State revenue is greatly affected by changes in the total taxable income of the community, and, for this reason, the graphs also illustrate fluctuations in the national income in those cases in which statistics are available.

In every country for which statistics are available, the total national income, when measured in money values, declined seriously during the great depression.¹ With this decline in national income there was a decline in the yield of taxation; and, in spite of almost universal attempts to offset this tendency by raising existing rates or by introducing new taxes, there was, in most cases, a serious decline in the revenue of the States. Of the countries illustrated in the graphs on pages 46 and 47, only Sweden and the United Kingdom showed no appreciable decline in revenue. In many cases, such as Germany, Hungary, the United States, Canada, Belgium, Bulgaria and France, the decline in total revenue was very great.

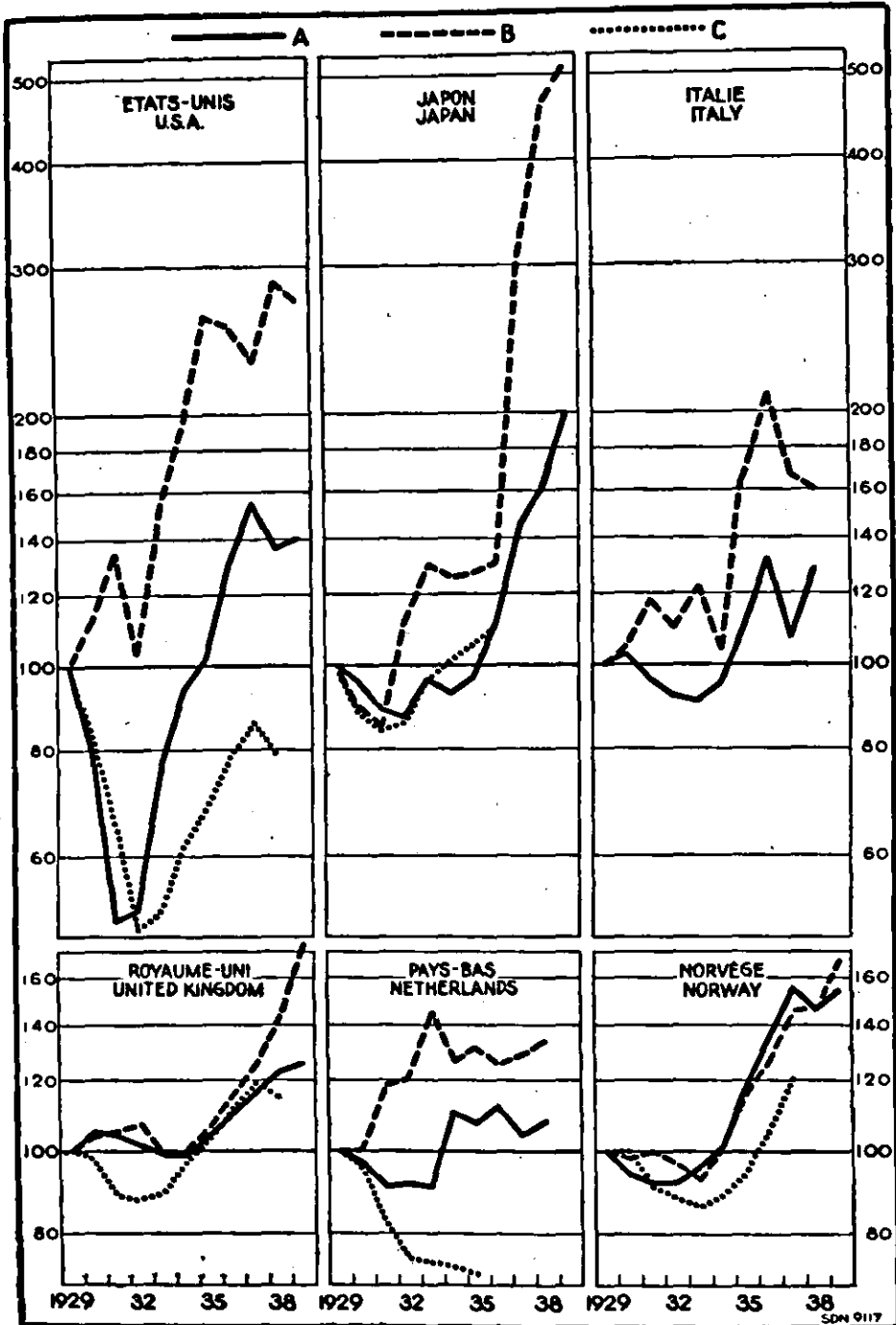
On the other hand, State expenditure showed little or no automatic tendency to decline. In some branches of State expenditure, moderate economies were automatically achieved by the fall in the prices at which supplies could be purchased. But large blocks of expenditure upon debt service, pensions

¹ Figures for national income are given in the table on page 84. Great care must be taken in interpreting these figures, for there are a number of differences in definition and in the method of measuring the national income, and the basic material from which the estimates are made is in many cases of a rough and approximate nature. For these reasons, international comparisons are difficult; but the figures probably give a more reliable picture of the changes in national income in each country from year to year.

Total National Income and State Revenue and Expenditure.
(1929 = 100.)

A State Revenue. B State Expenditure. C Total National Income.

Logarithmic Scale.

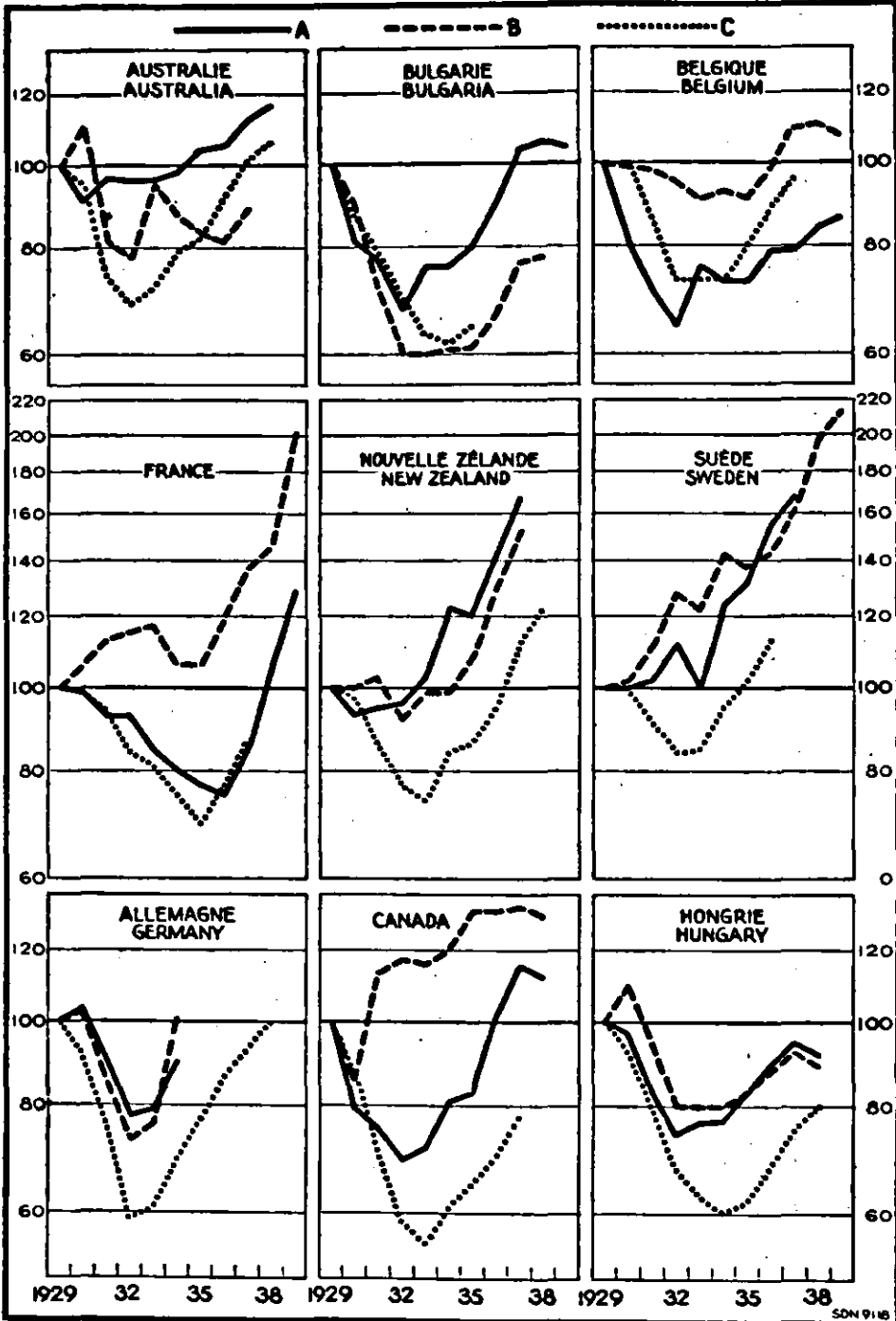


NOTE. — State revenue excludes the proceeds of loans, and, wherever possible, expenditure excludes the repayment of debt but includes other capital expenditure. For notes on the individual countries, see the notes to the table on page 51. For the figures for national income and their sources, see the table on page 84.

Total National Income and State Revenue and Expenditure.
(1929 = 100.)

A State Revenue. B State Expenditure. C Total National Income.

Logarithmic Scale.



NOTE. — State revenue excludes the proceeds of loans, and, wherever possible, expenditure excludes the repayment of debt but includes other capital expenditure. For notes on the individual countries, see the notes to the table on page 51. For the figures for national income and their sources, see the table on page 84.

and salaries were fixed in money values; and, as will be shown later (*cf.* page 63) increased expenditure for the relief of unemployment automatically imposed a heavier burden as the slump was intensified. Moreover, in a number of countries (*cf.* pages 63 to 68), at a later stage of the depression or during the subsequent period of recovery, special expenditure on public works of one form or another was undertaken to combat unemployment. For example, the rapid growth of expenditure in the United States was mainly due to emergency expenditure of this type. As a result, in a number of countries, such as the United States, Canada, France, the Netherlands and Italy, expenditure continued to rise in spite of a considerable fall in revenue; and in nearly all the countries shown in the graphs on pages 46 and 47, expenditure either rose more than, or fell less than, revenue. Germany, which is an important exception to this rule, enjoyed a large reduction in expenditure through the virtual cessation of reparation payments in 1931 and 1932.

During the first stages of the depression, measures were almost universally taken to restore the balance between revenue and expenditure by means of severe economies and by the imposition of increased rates of taxation. For example, in India, Switzerland, Belgium, Poland, Argentine, New Zealand, the United Kingdom, Germany, France and the United States of America — to mention only a limited number of possible illustrations — the rates of existing taxes were severely raised or new crisis taxes were introduced. In all these countries, serious economies were also attempted, in many cases by the reduction of salaries and pensions and by the postponement of expenditure on capital construction at least in the early stages of depression. In some countries, such as the United Kingdom, economies included reductions in the rate of unemployment benefits. Japan reduced expenditure to a minimum in 1931/32, mainly by the postponement of expenditure on capital works. Italy, on the other hand, increased expenditure on public works in 1931/32 as a method of combating unemployment, but later diminished these expenditures again and economised by such means as reducing salaries. Germany not only enjoyed budget relief from the suspension of reparations, but also effected economies in many other forms of expenditure.

But these attempts to redress the balance of public revenue and expenditure were in the main unsuccessful. As the table on pages 50 and 51 shows, in the United States, India, Belgium, France, Poland, Sweden, Switzerland and the United Kingdom, budget surpluses gave place to deficits, in spite of measures of economy and increased taxation; and, in Italy and Japan, existing deficits were much increased.

In fact, all countries were suffering from a serious decline in national income during the slump. In consequence, most countries found that it was impossible to prevent a serious decline in State revenue until the level of taxable income had been restored either by deliberate measures of reflation or by the operation of the normal forces of recovery. At the same time, serious difficulties were experienced in attempts to reduce expenditure so long as the cost of unemployment remained at a high level; and indeed attempts to reduce State expenditure were liable to defeat their own object by reducing the State's demand for goods and services and so by deflating the national income to even lower levels.

In the later stages of the depression and in the subsequent years of recovery, many countries achieved certain reductions in expenditure, which will be illustrated in a later section. The virtual suspension of reparations and inter-Governmental war debts since 1931 reduced the burden on a number of budgets. But these reductions, while they provided a real alleviation to some countries — and, in particular, to Germany — were balanced by an equivalent reduction of revenue on the part of countries such as France and the United States, which received a substantial net revenue from such sources. The depression, combined with an expansive monetary policy, brought with it a very considerable reduction in interest rates, which enabled many Governments to convert their debts to lower rates of interest and to finance their short-term borrowing on much cheaper terms. As will be seen later, this provided an important economy for certain countries, of which the United Kingdom is an outstanding example. At a later stage, the recovery from depression reduced unemployment, and this relieved State budgets from some of the excessive costs of unemployment relief. The savings on unemployment relief were particularly marked in Germany.

But the graphs on pages 46 and 47 show that, in spite of these economies, total State expenditure has, in many cases, continued to rise, and, in the great majority of cases, is now considerably higher than the 1929 level. Three main factors, which will be illustrated in more detail in later sections of this chapter, are responsible for this high level of expenditure. In the first place, there has been a continual development of social services in many countries. Secondly, while there was a general tendency to postpone State expenditure on capital development during the early years of the depression, this policy was later reversed in a number of countries. Thirdly, in quite recent years, by far the most important factor raising the general level of State expenditure has been the unprecedented

State Revenue, Expenditure and Budget Surplus (+) or Deficit (-).

(National currency, 000,000's.)

Estimates in italics.

A. Total Receipts. B. Total Expenditure. C. Surplus (+) or Deficit (-).

		1929 1929/30	1932 1932/33	1933 1933/34	1936 1936/37	1937 1937/38	1938 1938/39
United States . . .	A	4,044	2,084	3,121	5,307	6,242	5,520
	B	3,300	3,402	5,133	8,409	7,626	9,492
	C +	744	- 1,318	- 2,012	- 3,102	- 1,384	- 3,972
Argentine	A	764	767	764	924	993	945
	B	994	827	1,039	1,157	1,223	1,152
	C -	230	- 60	- 275	- 233	- 230	- 207
India	A	1,306	1,162	1,124	1,227	1,217	1,185
	B	1,267	1,180	1,174	1,215	1,200	1,192
	C +	39	- 18	- 50	+ 12	+ 17	- 7
Japan	A	1,536	1,331	1,484	1,710	2,219	2,506
	B	1,736	1,950	2,255	2,282	5,312	8,013
	C -	200	- 619	- 771	- 572	- 3,093	- 5,507
U.S.S.R.	A ^a	7,364	27,109	35,746	73,565	92,094	124,908
	B ^a	8,105	30,740	35,667	78,715	97,119	131,138
	C ^a -	741	- 3,631	+ 79	- 5,150	- 5,075	- 6,230
Belgium	A	13,613	8,832	10,341	10,708	10,740	11,384
	B	12,299	11,626	11,187	12,052	13,348	13,546
	C +	1,315	- 2,794	- 846	- 1,344	- 2,608	- 2,162
France	A ^b	48,177	47,944	43,436	38,677	44,047	54,776
	B ^b	44,248	53,428	54,945	55,789	65,483	68,971
	C ^b +	3,929	- 5,484	- 11,509	- 17,112	- 21,436	- 14,195
Germany	A	7,510	5,822	5,932	.	.	.
	B	8,187	5,965	6,189	.	.	.
	C -	677	- 143	- 257	.	.	.
Hungary	A	1,447	1,076	1,119	1,313	1,369	1,335
	B	1,478	1,184	1,185	1,305	1,381	1,335
	C -	31	- 108	- 66	+ 8	- 12	-
Italy	A	20,423	18,712	18,601	26,940	21,891	...
	B	20,519	22,586	25,017	43,090	34,100	...
	C -	96	- 3,874	- 6,416	- 16,150	- 12,209	- 12,759
Poland	A	3,029	1,930	1,915	2,217	2,373	2,475
	B	2,878	2,182	2,232	2,167	2,291	2,414
	C +	151	- 252	- 317	+ 50	+ 82	+ 61

^a 1928/29.
^b 1928.
^c 1931/32.

		1929 1929/30	1932 1932/33	1933 1933/34	1936 1936/37	1937 1937/38	1938 1938/39
Sweden	{ A	796	893	795	1,234	1,340	...
	{ B	770	984	941	1,101	1,250	...
	{ C +	26	- 91	- 146	+ 133	+ 90	...
Switzerland	{ A	474	466	458	569	559	...
	{ B	391	486	532	636	575	...
	{ C +	83	- 20	- 74	- 67	- 16	...
United Kingdom	{ A	815	827	809	897	949	1,006
	{ B	782	833	770	889	974	1,134
	{ C +	33	- 6	+ 39	+ 8	- 25	- 128
New Zealand	{ A	26.1	25.0	26.9	37.2	43.4	...
	{ B	29.8	27.3	29.6	38.4	45.4	...
	{ C -	3.7	- 2.3	- 2.7	- 1.2	- 2.0	...

NOTES. — Receipts exclude the proceeds of loans. Expenditure excludes amortisation of debt unless otherwise stated.

Argentine: Receipts exclude profit from revaluation of gold in 1935. *India:* Receipts exclude withdrawal from reserves. *Japan:* Expenditure includes extraordinary expenditure for operations in China. *U.S.S.R.:* Expenditure includes amortisation of debt. *Belgium:* Receipts exclude profits from the revaluation of gold and from the withdrawal of fifty-franc notes. Expenditure includes ordinary amortisation of debt, but excludes extraordinary expenditure on debt in 1930, 1935 and 1936. *Bulgaria:* Revenue includes withdrawals from special funds, but excludes surplus from previous years and coinage receipts. Expenditure includes ordinary amortisation. Since 1935, untransferred service on foreign debt is included also in revenue. *France:* Excludes the Autonomous Amortisation Fund and Special Treasury Accounts. Expenditure excludes certain military and civil extraordinary expenditure before 1936, but includes the *Fonds d'armement, d'outillage et d'avances sur travaux* and the *Compte des investissements en capital* since 1936. *Germany:* Expenditure includes amortisation of debt. No accounts have been published since 1934/35. *Italy:* Expenditure includes extraordinary expenditure in Africa and Spain, estimated at 9,000 and 6,500 million lire for 1937/38 and 1938/39 by the Minister of Finance. The budget deficit for 1938/39 was forecast by the Minister of Finance in May 1939. *Sweden:* Receipts include the employment of assets from various funds. *United Kingdom:* Expenditure includes expenditure under Defence Loan Act 1937. *Australia:* Expenditure includes Revenue Account and Loan Fund. *New Zealand:* Includes Public Works Fund and Unemployment Fund.

peace-time scale of rearmament expenditure and, in the cases of Italy and Japan, expenditure for the conduct of war itself.

Since the worst years of the depression, there has been a general rise in national incomes. The graphs on pages 46 and 47 show clearly that, with the recovery in national income, State revenues rose again; and, as a result of the continuation of higher rates of taxation, there has been a general tendency for State revenue to remain higher in relation to national income than in 1929. But this tendency has been outweighed by the rise in expenditure; and, as the table on pages 50 and 51 shows,

budget deficits which appeared during the slump as a result of the decline of revenue and the cost of unemployment have, in many cases, been continued, and in some cases greatly increased, in consequence of emergency expenditure to combat unemployment and the costs of present rearmament programmes. Only relatively few countries, such as India, Poland and Sweden, which enjoyed budget surpluses in 1929 and experienced serious budget deficits during the depression years, have been able again to achieve a surplus of revenue over expenditure.

The importance of present budgetary deficits can perhaps be most readily illustrated by the following figures, which are based on budget estimates:

*Percentage of State Expenses covered by Revenue other than the Proceeds of Loans.**

	%		%
Japan. 1939/40	35	U.S.S.R. 1938	95
United States. 1939/40	63	New Zealand. 1937/38.	96
France. 1940	70	Switzerland. 1937	97
Argentine. 1939	70	Hungary. 1938/39.	100
United Kingdom. 1939/40	73	Poland. 1939/40	102
Italy. 1938/39	80	India. 1939/40	103
Belgium. 1939	89	Sweden. 1937/38	107

* *New Zealand, Switzerland, and Sweden*: Closed accounts.

Other countries: Estimates.

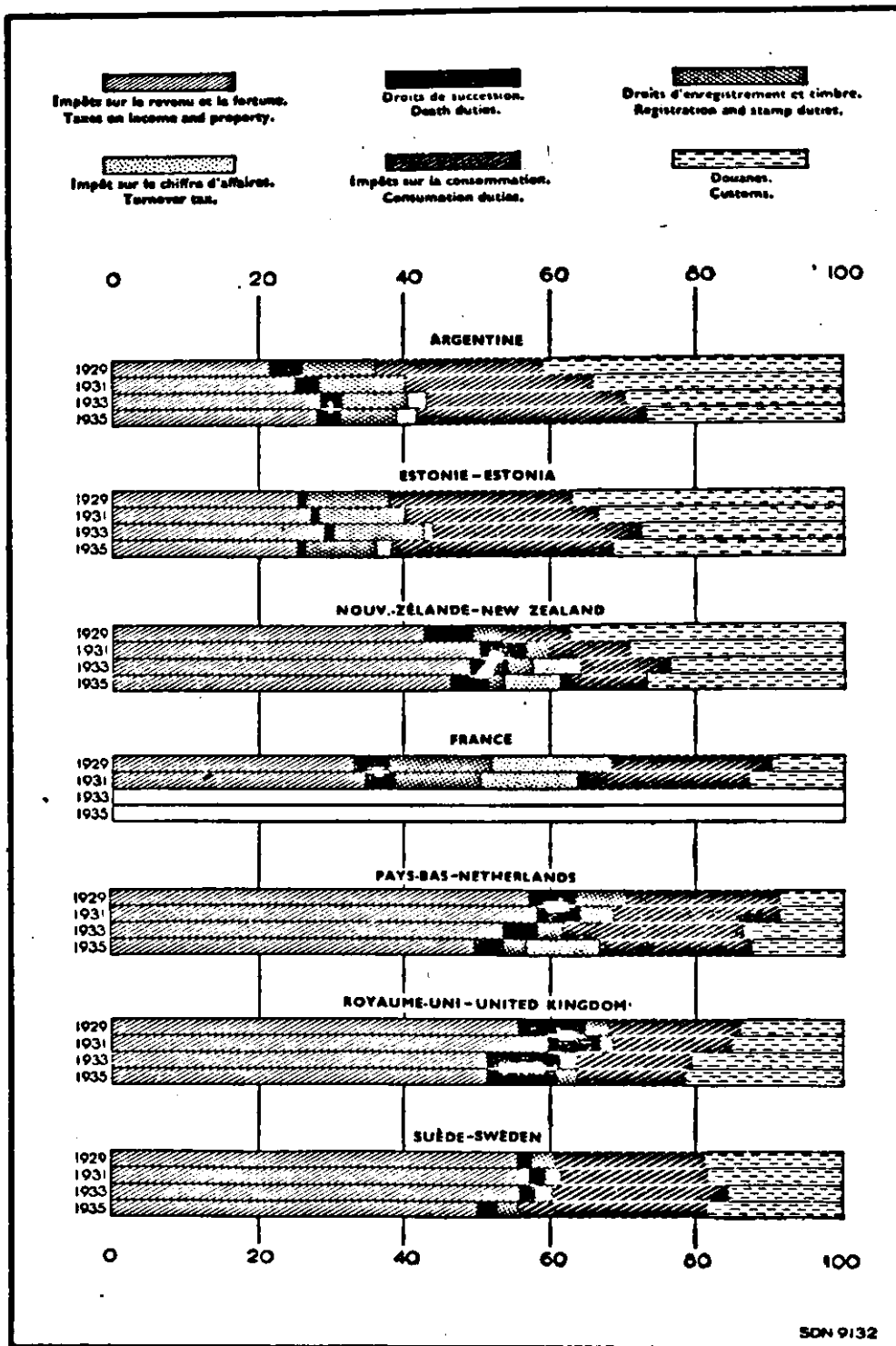
State expenditure excludes repayment of debt except in Japan, Argentine, Belgium, United Kingdom, Hungary, Union of Soviet Socialist Republics.

CHANGES IN THE YIELD OF TAXATION

After a considerable decline during the post-1929 depression, the yield of taxation in most countries has risen again with the subsequent recovery of trade activity. But the experience of different countries has varied both because of differences in the economic and fiscal policies which they have adopted and because of differences in their economic structure.

The graph on page 53 illustrates the structure of the tax revenue in a certain number of agricultural and industrial countries. It covers the total tax revenue, not only of the State budgets, but also of the various local authorities. Local authorities are generally precluded from levying import duties or taxes on consumption, and are, in the main, confined to raising their revenue by the taxation of fixed property. For this reason, as the following figures show, the effect of including the tax revenue of local authorities is to increase for all countries

Various Tax Receipts of the State and Other Public Bodies as a Percentage of Total Tax Revenue.



the proportion of the total tax receipts which is obtained by the taxation of income and property:

Taxes on Income and Property^a as a Percentage of Total Tax Revenue, 1935

	State only	State and other public bodies combined
Estonia	13	26
Argentine	19	28
France ^b	27	34
New Zealand	36	46
Sweden	23	50
Netherlands	22	51
United Kingdom	39	51

^a Excluding death, stamp and registration duties.
^b 1931.

This table also underlines one of the most important differences shown by the graph. While the revenue from taxes on income and property and from consumption and Customs duties combined is always of outstanding importance and accounts for some 80% to 90% of the total yield, taxes from income and property are of paramount importance in the industrial countries, whereas agricultural countries obtain the greater part of their revenue from customs and consumption duties. In industrial countries, such as the Netherlands, the United Kingdom and Sweden, taxes from income and property account for 50% of the total tax revenue. France, which is also highly industrialised, is an exception to this rule; but, in this country, the registration and stamp duties and the turnover tax are peculiarly fully developed.

In the countries producing raw materials and agricultural products, such as the Argentine, Estonia and New Zealand, Customs duties are of much greater importance than in the industrialised States.¹ In such countries, taxes from income and property generally play a relatively small part, while consumption duties and registration and stamp duties are normally of greater importance. In New Zealand, income taxation is of unusual importance for an agricultural State; but

¹ This is generally true of all agricultural States; but there are certain outstanding exceptions. In Poland, for example, the yield of Customs duties is relatively unimportant, and this may be due to the fact that, in that country, the level of Customs duties is exceptionally high, so that the total yield is diminished through the severe restriction of imports.

this country, together with a few other agricultural States, such as Denmark, is in a special position. For, while it is primarily agricultural, its agricultural system is organised to some extent on an industrial basis, so that it has some of the characteristics of an industrialised country.

During the period 1929 to 1935, there was a marked fall in the relative and absolute importance of Customs duties in agricultural countries, such as the Argentine, Estonia, New Zealand, Bulgaria, Greece and Poland. Such countries have been particularly affected by the fall in the value of world trade, for they already relied greatly upon the yield of Customs duties or had developed a system of high protection, and were therefore unable to develop these sources of taxation to any very great extent. Partly as a direct consequence of this and partly as a result of their general economic evolution, such countries have developed other sources of revenue in addition to raising existing excise duties. Thus, the Argentine, Estonia, Greece and New Zealand have all introduced turnover taxes since 1929, New Zealand introduced a special charge to meet the costs of unemployment and the Argentine has introduced a general income tax. On the other hand, the relative importance of Customs duties has risen in such industrialised countries as France,¹ the Netherlands, Belgium and the United Kingdom; and, in Sweden, it has shown no appreciable decline between 1929 and 1935. In such industrialised countries, the abandonment of free trade or the raising of existing import duties seems to have been of greater importance than the decline in the value of world trade.

So many changes have taken place in the rates of different taxes in the various countries that it is very difficult to make any generalisation about the behaviour of the yield of different taxes in the course of the great depression and the subsequent recovery. The table on page 56, however, illustrates for a number of countries the changes in the yield of certain taxes, which might be expected to be most sensitive to fluctuations of business activity; and the figures show that, in spite of various changes in the rates of taxation, there was a clear tendency for tax yields to fall between 1929 and 1933 and to rise between 1933 and 1938.

This tendency is clearest in the case of the income tax. In India, the rates of income tax were raised during the depression to compensate for the decline in other revenues, and were subsequently reduced again as the yield of other revenues recovered.

¹ The increase in the relative importance of Customs duties in France between 1929 and 1931, as shown in the graph on page 53, has continued in more recent years, as far as can be judged from the figures of the State budget alone.

In every other country shown in the table, the yield of income tax fell between 1929 and 1933 and rose between 1933 and 1938. Moreover, in every country, except India and Belgium, the yield of the income tax by 1938 had at least regained the 1929 level; and in countries such as Japan, Germany, Italy and the United Kingdom, where there has been a substantial rise both in the national income and also in the rates of taxation, the yield has risen considerably above the 1929 level.

Fluctuations in the Yield of Various Taxes.

(1929 or 1929/30 = 100.)

Estimates for 1938 or 1938/39.

Country	Taxes on income		Excise duties		Customs duties	
	1933 or 1933/34	1938 or 1938/39	1933 or 1933/34	1938 or 1938/39	1933 or 1933/34	1938 or 1938/39
United States.	34	100	232	328	54	67
India	102	84	177	193	84	92
Japan	80	324	86	122	84	129
Belgium	54	73	129	311	113	125
France.	83	107	91	91 ^a	113	169
Germany.	43	134 ^a	95	141 ^a	97	146 ^a
Hungary	92	108	88	104	38	52
Italy	87	147	76	117	94	89
Poland	62	123	88	95	24	44
United Kingdom	96	137	84	91	149	190

^a 1937 or 1937/38.

On the whole, the yield of excise duties seems to have been more easily maintained during the depression of trade activity than the yield of the income tax; for, in seven out of the ten countries shown in the above table, the yield of the income tax declined more than the yield of excise duties between 1929 and 1933, and, in the remaining three countries, the decline in the yield of excise duties was not much greater than that of the income tax. But excise duties have also fluctuated with the level of business activity. In all the countries shown in the table, except the United States, India and Belgium, the yields fell between 1929 and 1933; and, in every case, there was some rise in yield between 1933 and 1938. The very large increases of yield which are shown in the case of Belgium and the United States are due to substantial increases in the rate of duty. In the United States, for example, manufacturers' excise duties, including an important duty on petrol, were imposed in 1932;

and, since 1933, the repeal of prohibition has led to important increases in the yield of these duties. Many other countries, such as India, Japan, Germany and Italy, in which the yield from excise duties in 1938 was considerably above the 1929 level, have also introduced important new duties or have considerably raised existing excise duties during this period. On the other hand, the declining yield in the United Kingdom is largely due to a declining consumption of spirits and other alcoholic drinks.

In the case of Customs duties, seven out of the ten countries shown in the table experienced a decline in yield between 1929 and 1933; and, in every case, except Italy, the yield of Customs duties rose again between 1933 and 1938. But there have been very great divergences in the yield of Customs duties in the various countries between 1929 and 1938. In five cases, the yield had risen, and, in five cases, it had fallen during these ten years. In every country, there have been important increases in the rates of duty during this period. But, on the other hand, the fall in the total value of imports — which, in many cases, has been largely due to increased rates of Customs duties — has tended to reduce the yield. The important increase in the yield of Customs duties in the United Kingdom is due to the imposition of a tariff, at non-prohibitive rates, as a result of the abandonment of the policy of free trade. But, in many other countries in which duties which were already high have been still further raised, or in which imports have been severely restricted by quotas and by the development of internal substitutes for previously imported commodities, the yield of Customs duties has remained very considerably below the 1929 level.

RISING STATE EXPENDITURE

Throughout the years which have elapsed since 1929, there has been a general tendency for State expenditure to rise. This is the clearest conclusion which is to be derived from the table on pages 50 and 51. In practically every country shown in that table, total expenditure in 1936, 1937 and 1938 is substantially higher than in 1929. But this rise in expenditure is not only a phenomenon of the most recent years. In most cases, no net reduction of expenditure was achieved even during the worst years of the depression; and, in many countries, total expenditure in 1933 was already considerably higher than in 1929. Moreover, as the following figures show, the increase in total State expenditure has been such as to represent in most cases a considerably higher proportion of the total national income.

*Total State Expenditure
as a Percentage of Total National Income.¹*

	1929	1932	1933	1936	1937	1938
	%	%	%	%	%	%
Canada	7	14	14	13	...	...
United States	4	8.5	12	13	11	15
Japan	15	19	20	17	...	(42-45)
Belgium	18 ^a	23	.	21	20	...
France.	19	26	28	29.5	...	(28)
Germany.	11	13	13	.	.	.
Hungary	25	30	32	33	31	28
Norway	16	18	17.5	20	19	...
Sweden	10 ^a	15	15	13	...	...
United Kingdom	18	22	19	18	19	(23)
Australia.	22	25	29	19	...	...

^a 1930.

REARMAMENT EXPENDITURE

The table opposite illustrates the most important cause of increasing expenditures in recent years — namely, the rising tide of expenditure on armaments. Such expenditure has come to represent, not only an extremely heavy burden upon national budgets, but also a very considerable drain upon the total national income, as the figures on the opposite page show.

Moreover, the figures of State expenditure on national defence do not measure the total economic burden which has been imposed by the recent growth of rearmament activity. For there are a number of indirect economic effects of such rearmament which do not appear in these figures. For example, "in conscript countries, there is the expense of maintaining large sections of the working population in unproductive occupations during their most fruitful years; in almost all countries there are the costs of national self-sufficiency — tariffs, subsidies to industries producing substitutes, uneconomic diversions of resources into agriculture, various sorts of 'planning' for strategic purposes (such as the reorganisation of road and rail transport to serve threatened frontiers), replanning urban settlement so as to minimise air-raid risk, neglecting export markets for domestic armament orders, etc., a great

¹ For the sources of the national income figures, see the table on page 84. Great caution should be observed in using these figures for international comparisons, but more reliance may be placed upon comparisons of the changes within each country. The figures in brackets are not strictly comparable.

Expenditure on National Defence.

(National currency, 000,000's.)

Estimates in italics.

	Currency	1929 1929/30	1937 1937/38	1938 1938/39	1939 1939/40
United States . . .	Dollar	703	1,033	<i>1,120</i>	<i>1,169</i>
Japan	Yen	495	<i>4,422</i>	<i>6,097</i>	<i>6,432</i>
U.S.S.R.	Rouble	912 ^a	<i>20,102</i>	<i>27,044</i>	<i>40,885</i>
France	Franc	10,687	<i>19,023</i>	<i>27,118</i>	<i>46,032</i>
Italy	Lira	4,654	<i>14,262</i>	<i>12,027</i>	...
Poland	Zloty	880	772	800	800
Sweden	Krona	138	185	278	272
Switzerland	Franc	85	160	214	...
United Kingdom . .	£	96	248	382	608
New Zealand	£NZ	0.9	1.6	2.0	...

^a 1928/29.

NOTES. — Figures, taken from the budget accounts of the various countries, exclude expenditure on pensions, except in the U.S.S.R. *Japan*: Including expenditure in China. *France*: Including extraordinary expenditure since 1936. *Italy*: Including extraordinary budget for Africa. *Poland*: Not including National Defence Fund. *United Kingdom*: Including expenditure on passive defence, and expenditure from loans, estimated at £380 million for 1939/40. Additional expenditure of more than £100 million for 1939/40 was announced in July 1939.

	As percentage of total State expenditure				As percentage of total national income			
	1929	1937	1938	1939	1929	1937	1938	1939
United States . . .	21	14	12	13	0.9	1.4	1.7	1.8 ^a
Japan	28.5	83	76	72	4	...	(32-34)	...
U.S.S.R.	11 ^b	21	21	...	.	.	.	.
France	23	29	39	49	4	9	11	(18) ^a
Italy	23	43	37	...	.	12 ^c	.	.
United Kingdom . .	12	25	34	43	2	5	(8)	(12) ^a

NOTES. — Figures in brackets are not strictly comparable.

On the basis of national income for 1938.

^b 1928/29.

^c Based on estimate of national income of 120,000 million lire. Cf. William T. Stone: "Economic Consequences of Rearmament"; *Foreign Policy Report*, October 1st, 1938.

deal of which need never appear as Government expenditure at all, much less as part of the national defence budget".¹

On the other hand, increased State expenditure on armaments has probably helped, in some countries, to preserve business activity at a high level. It may, in fact, have had the same immediate effect as a policy of reducing unemployment through a programme of public expenditure on capital construction. In many cases, a large part of recent rearmament programmes have not been financed by increased taxation, which might have led to an equal reduction of expenditure on the part of private individuals and private enterprise, but by State borrowing combined with the creation of liberal supplies of money through the banking systems. They have therefore probably imposed as small a drain as possible on funds available for private enterprise, and have helped therefore to swell the general demand for goods and services.

But even as a substitute for a programme of public works, rearmament has had many disadvantages. Expenditure on armaments is economically unproductive. Useful public works, on the other hand, would themselves have helped to raise standards of living. Moreover, in the case of housing and of public utility construction, they would also have been productive in the narrower sense of bringing in to the public authorities an additional revenue which would have covered some part at least of the service of the debt incurred for their construction. Moreover, as a means of taking up the slack of private enterprise in times of depression, rearmament expenditure has been badly timed. For it has grown during the later stages of business recovery, in 1935, 1936 and 1937 rather than during the worst years of depression. In some cases, as in Germany, it has gone so far that not only have all the suitable unemployed resources been brought into use, but also labour and capital have been diverted from useful activity in other sections of the economy. On the other hand, during the recession in trade activity in the last part of 1937 and in 1938, in a number of countries rearmament expenditure may have been well timed as a substitute for useful works of capital construction.

Even during this recent recession, however, increased expenditures on rearmament did not provide an equivalent net additional stimulus to business, even though they were generally financed in such a way as to impose as small a drain as possible on private resources. For rearmament is associated with international uncertainty and with a lack of confidence

¹ A. S. J. BASTER: "Some Economic Aspects of Rearmament", pages 169-170, *International Labour Review*, February 1938. In a later passage, Mr. Baster (*op. cit.*, pages 187-188) gives some interesting illustrations of the costs of such policies.

on the part of private business as to the future prospects of their enterprises; and, for this reason, increased expenditure on armaments has been offset, at least in part, by a reduction in private expenditure on capital extensions.

Two further economic difficulties have been occasioned by these expenditures. In the first place, they have led to the continuation of large budget deficits, as can be seen from the table on pages 50 and 51. This already threatens to lead to budgetary difficulties, since a growing amount of the national incomes will have to be raised in taxation to meet the interest and amortisation of these new debts. These debts have been incurred largely at a time when they were not needed to stimulate business activity, and they have been spent on objects which will not produce any revenue from which part of the service of the debt may be met. Secondly, heavy expenditure on rearmament is draining men and resources into certain specific branches of the constructional industries, which, in some cases, were already overdeveloped for the satisfaction of ordinary peaceful demands. Capital which is invested in certain specific forms and labour which is trained for certain skilled work for armament construction cannot readily be shifted into other occupations. When the rearmament expansion comes to an end, many countries will be faced with grave problems of economic "demobilisation", which may cause serious unemployment; and, as will be shown in Chapter VI, such problems of structural unemployment will probably be particularly serious in future years in many countries which are threatened with a decline of population. Whereas public works programmes can to some extent be devised to expand the demand for those types of labour and capital which are already available and unemployed, in planning rearmament little, if any, attention can be paid to these considerations.

THE DEVELOPMENT OF SOCIAL EXPENDITURE

Underlying the recent expansion of expenditures on national defence, there has been a more normal and long period expansion of expenditure on social services. The table on page 62 gives a few illustrations of this development.¹ In all the countries shown in the table, with the exception of Poland, expenditure on social services has increased appreciably in recent years. In some countries, such services have recently been greatly expanded; and these developments are illustrated by New Zealand, Sweden, the Union of Soviet Socialist Republics and

¹ The figures include, wherever possible, expenditure on public health, education and pensions, but exclude expenditure on unemployment. The figures refer only to State expenditures, except in the case of Great Britain, where they include also the expenditures of local authorities.

the Argentine. In other countries not shown in the table, such developments have also recently occurred. In the United States, for example, old-age and other pensions have recently been instituted on a large scale under the social security legislation; and Japan, during the war against China, has organised a Ministry of Social Welfare with estimated expenditure of 0.8 and 143.4 million yen for 1937/38 and 1938/39 respectively.

Expenditure on Social Services.

(National currency, 000,000's.)

Estimates in italics.

	Currency	1929 or 1929/30	1931 or 1931/32	1933 or 1933/34	1935 or 1935/36	1937 or 1937/38
New Zealand . . .	£NZ	6.7	6.6	6.8	7.8	11.9
Poland	Zloty	526	402	381	354	384
Sweden	Krona	247	274	270	310	443
U.S.S.R.	Rouble	529 ^a	1,256	2,306	4,804	10,870
Argentine	Peso	143	126	113	181	216
France	Franc	.	4,953	5,083	4,885	5,415
Great Britain . .	£	305	326	332	352	358 ^b

^a 1928/29.
^b 1936/37.

NOTES. — *New Zealand*: Pensions and social services, including education. *Poland*: Health service and general expenditure of Ministry of Social Welfare and Ministry of Church and Education. *Sweden*: Expenditure of Ministries of Religion and Education and of Social Welfare, excluding expenditure on unemployment. *U.S.S.R.*: Social and cultural expenditure. *Argentine*: Ministry of Justice and Education. *France*: National education, and public health and physical education. *Great Britain*: Expenditure by State and local authorities on social services other than unemployment and public assistance, from U. K. Hicks: *The Finance of British Government, 1920-1936*, page 383.

Even in countries such as France and the United Kingdom, where the development of such services dates from much earlier years, recent expansion has nevertheless been important. Thus it has been estimated that, in the United Kingdom, while expenditure on armaments and the service of the national debt only rose from 10½% to 11½% of the national income between 1929 and 1938, expenditure on all other objects rose from 7% to 9% of the national income during the same period.¹

¹ See the *Economist*, June 11th, 1938; special supplement on "The Long-term Budget Problem". During this period, a fall in interest on the national debt due to the suspension of payments on the debt to the United States and to conversion of the debt on to the basis of lower interests rates in part compensated for increased expenditure on armaments.

THE COST OF UNEMPLOYMENT AND PUBLIC WORKS

In addition to expenditure on armaments and on social services, two other objects of expenditure have made increasing demands upon the State in many countries since 1929 — namely, expenditure for the direct relief of unemployment and expenditure on capital works, which, in many cases, were undertaken in the later stages of the great depression and during the recovery to combat unemployment. In many countries, expenditure on the direct relief of unemployment rose greatly during the depression, but was reduced as the recovery developed and unemployment diminished; and, on the other hand, expenditure on public works was reduced in many countries as a measure of economy during the worst years of the depression, but was later increased with the object of combating unemployment. Certain figures are given in the table on page 64, which illustrate these movements within various countries.¹

All the countries for which the relevant figures are given in the table show a large increase in the cost of unemployment relief between 1929 and 1932; and, in all of them, except Belgium and Switzerland, there has been some reduction in the cost of such relief with the recovery of business activity in recent years. But, in a number of countries, such as the United States, Switzerland, Sweden, Belgium and Great Britain, the cost of unemployment relief has remained on a considerably higher level than in 1929. For, in some cases, complete recovery of trade activity has been delayed; in others, a higher level of unemployment has remained as a result of structural changes in industry due, for example, to the disappearance of certain export markets; and, in others, State aid to unemployment has, largely as a result of the depression, been permanently extended.

A number of interesting developments are illustrated by the figures given for expenditure on capital works. In a great number of countries — such as India, Italy, the Argentine, New Zealand, Poland and Belgium — such expenditure fell between 1929 and 1932; and, in all these countries except the Argentine, it has subsequently risen again. Such changes in expenditure on public works have also occurred in many countries which are not shown in the table. In Japan, for example, public works expenditure was reduced as a measure of economy during the first years of the depression. With the onset of the depression, many countries postponed such expenditure as one of the few practicable measures of economy which could be adopted to meet the fall in revenue. The subsequent

¹ Owing to the great differences of economic organisation and of methods of budgeting, it is impossible to obtain figures which are strictly comparable as between the various countries.

increase in such expenditures was, in part, a result of the natural reversal of these economies as the budgetary situation improved with the recovery in trade activity; but, in many countries, it was due also to a deliberate change of economic policy, and large schemes of public construction were undertaken during the years of recovery from the depression as a method of reducing unemployment.

Expenditure on Unemployment and on Capital Works.

(National currency, 000,000's.)

Estimates in italics.

A. Expenditure on unemployment. B. Expenditure on capital works.

		1929 or 1929/30	1932 or 1932/33	1936 or 1936/37	1937 or 1937/38	1938 or 1938/39
India	B	320	19	29	33	83
Switzerland	A	2	25	50	48	54
Italy	B	1,841	1,621	1,729	1,746	...
United States	A	—	360	2,527	1,996	2,741
	B	—	472	1,102	880	1,229
Sweden	A	4	44	28	22	18
	B	47	96	140	126	139
Argentine	B	55	48	32	35	30
New Zealand	A	—	3.8	4.4	4.2	...
	B	6.2	2.3	5.0	7.6	...
Poland	A	53	72	4	3	17
	B	191	41	42	51	74
Belgium	A	40	74.9	699	607	891
	B	718	516	855	1,898	1,368
Great Britain	A	98	162	138	...	...

NOTES. — Except for Great Britain figures refer to State expenditure only.

India: Railways, Irrigation, Posts and Telegraphs and other capital outlay not charged to revenue. *Switzerland:* Expenditure on unemployment. *Italy:* Public works. *United States:* A. Unemployment relief, including relief works and Civilian Conservation Corps. B. Public works. *Sweden:* A. Unemployment expenditure of Ministry of Social Welfare. B. See table on page 68. *Argentine:* Ministry of Public Works. *New Zealand:* A. Unemployment Fund. B. Public Works Fund other than repayment of debt. *Poland:* A. Unemployment relief. B. Ministries of Public Works and of Communications. *Belgium:* A. Expenditure on unemployment. B. Ordinary and extraordinary expenditure of Ministry of Public Works. *Great Britain:* Expenditure by State and local authorities on unemployment and public assistance, from U. K. HICKS: *Finance of British Government, 1920-1936*, page 383.

There are many instances of such a change of policy. Thus, the greatly increased expenditures on public works shown in

the table for New Zealand and Belgium are the result of a deliberate attempt in recent years to reduce unemployment by State expenditure. The figures for Belgium underestimate the magnitude of this policy. For they do not include a special expenditure of 633.6 million francs in 1936 financed out of part of the profit obtained by revaluing the gold reserves in consequence of the devaluation of the currency. Emergency expenditure on relief and public works has been continued in the United States on a high level since 1933, as a result of the "pump-priming" policy by means of which an attempt has been made to stimulate activity through increased Governmental expenditure. In 1936, France rejected the policy of deflation as a method of meeting the depression, which had developed later and had continued longer than in the majority of countries; and a new policy was adopted, which included an important scheme of expenditure on public works.¹

In Germany also, the depression was first met by a policy of deflation and of reduced public expenditure. Some attempts were made to reduce unemployment by schemes of expenditure on public works in 1932 and 1933; but it was not until 1934 that the policy of deflation was finally reversed. Since that date, vast sums have been devoted to public expenditure on public works and rearmament, so that, at present, there is a real scarcity of labour.

The figures in the table on page 64 for Poland show some increase in expenditure on public works since 1932; but these figures reveal only a small part of the change of policy in that country. Since 1936, a large programme of industrial development has been contemplated. All public investment has been brought under a single scheme; and large sums have been allocated for industrial investment from various sources including payments from the State treasury and local authorities, from accumulations of capital in such institutions as the Post Office Savings Bank and social insurance establishments, and to a limited extent from foreign loans such as the French loan of December 1936 of 2,600 million zloty. Such investments have been undertaken for many various purposes — as, for example, the development of communications and electrification — but, in the first years, have been concentrated mainly on national defence. It has been estimated that, in the four budget years 1932/33 to 1935/36, expenditure on public investment from all sources was at the average rate of 332.5 million zloty per annum, whereas such expenditure has risen to 512 millions in 1936/37,

¹ Recently, such expenditures have been much reduced again in an attempt to reduce the growing budgetary deficits, cf. pages 77 and 78 below.

994 millions in 1937/38 and 1,063 millions in 1938/39. It is estimated to reach 1,250 millions in 1939/40. Recently, a new plan has been formed for investment expenditure of 2,000 million zloty during 1939, 1940 and 1941, of which as much as 1,200 millions will be allocated to national defence purposes. This expenditure is envisaged as the first instalment of planned investment for a fifteen-year period, in the later years of which it is hoped that civil development will predominate.¹

A long-term policy of planned investment for the greater industrialisation of relatively undeveloped territories has occurred also in other countries. The Turkish Government, for example, has initiated schemes including the rapid development of roads and railways, agricultural reclamation and irrigation, public utility construction, mining development, and industrialisation which has been concentrated on the cotton and iron and steel industries by means of a five-year plan of industrialisation from 1934 to 1939. A second five-year plan is now contemplated which will concentrate on the electrical and chemical industries. State productive investment has risen from £T27 million in 1931/32 to £T45 in 1936/37. The greater part of this development has been financed by payments from the current revenue of the State or from levies on the municipal rates; and, to a large extent, these funds for development have been administered by various special banks. During the great depression, the current revenue of the State fell as in other countries; but severe economies were made in current expenditure and crisis taxation was introduced. It has been estimated that £T209 million were spent on State productive investment between 1931/32 and 1936/37, and that, of this, only £T55 was financed by loans.²

It has frequently been argued that expenditure on capital construction by public authorities should be so timed as to compensate as far as possible for fluctuations in private business. The figures of public works expenditure shown in the table on page 64 suggest, however, that, far from such a policy having been adopted, capital expenditure by the State was, in the majority of cases, diminished during the great depression and was subsequently increased again during the years of recovery.³ In many cases, this was probably inevitable. Countries such as the Argentine, India and New Zealand, which depend largely

¹ *Monthly Review of the National Economic Bank*; January and December 1938, and February 1939.

² As reported in *The Times*, Special Supplement, August 9th, 1938.

³ In Italy, however, State expenditure on public works, which was 1,841 million lire in 1929/30, rose to 2,877 million lire in 1931/32, as a result of a policy of increasing such expenditure in order to reduce unemployment. This expenditure fell again to 1,621 million lire in 1932/33.

upon the export of agricultural products, could not hope to compensate for the decline in foreign trade activity by public works development during the years of depression; and, in fact, they could not avoid the reduction of State expenditure as one measure designed to relieve the pressure on their foreign exchanges by reducing the demand for imported commodities. Industrialised countries whose foreign exchange position is not unduly strained during a depression may be able alone to adopt a policy of increased expenditure on public works; and indeed, by doing so they may help to relieve the pressure on the foreign exchange position of agricultural countries whose activity depends largely upon the import demands of industrialised countries. Germany, although she was in a relatively weak exchange position, has, since 1934, been enabled to adopt a policy of vast schemes of State expenditure by imposing a rigid system of exchange control which has prevented such a policy from exercising too severe a pressure upon her exchanges. Only if some international action is taken for the joint timing of State expenditure on capital construction can the majority of countries with relatively liberal foreign exchange relations hope to offset a depression by this policy without endangering their currencies.

In a few countries, such as Sweden and Finland, measures have been taken to meet two other difficulties which have frequently stood in the way of a public works policy. Schemes of capital construction cannot be readily improvised, and only if plans have been made in advance can such expenditure be effectively increased with the onset of a depression. Moreover, the finance of such expenditures must be so planned as to avoid an excessive increase in public debt; and, for this purpose, either a balance of funds must be accumulated in periods of good trade from which public works expenditure may be financed during a depression or else debt which is incurred for their finance during a depression must be repaid from the budget surpluses of good years.

In Sweden, a change of policy occurred in 1933, when it was determined to increase expenditure on public works in order to reduce unemployment and to repay these loans out of increased taxation in subsequent years of good trade. As the following figures¹ show, this policy was successfully adopted:

¹ From an article by the Swedish Minister of Finance on "The Financial Policy during Depression and Boom". *Annals of the American Academy of Political and Social Science*, May 1938. The figures for the budget surplus or deficit in this table exclude certain capital items of receipts and expenditure, and do not therefore correspond to those given in the table on page 51.

*Swedish Public Investment and Budgetary Surplus (+)
or Deficit (-).*

Kronor (000,000's).

	Total capital investments	Budget surplus (+) or deficit (-)
1929/30	47.1	+ 69.7
1930/31	43.0	+ 43.3
1931/32	79.5	- 40.9
1932/33	96.3	- 75.3
1933/34	169.2	- 94.7
1934/35	288.0	- 119.3
1935/36	157.6	+ 19.2
1936/37	139.7	+ 170.4
1937/38 (estimates)	126.2	+ 20.8
1938/39 (estimates)	138.8 ^a	+ 19.1

^a Excluding 70 million kronor to be used for the storage of imported commodities.

Total State investment was substantially increased after 1932, and was reduced again in the later stages of recovery.¹ Moreover, by means of increased revenue, due both to increased rates of taxation and also to the general recovery of trade, the debts incurred for financing public works have been successfully repaid from the budget surpluses of subsequent years of active trade. Preparations have been made to continue this policy in any future slump. At the end of 1937, a report was issued which analysed the capital expenditure plans of central and local authorities for future periods of five and ten years, so that schemes for development may be held in readiness. Moreover, a special supplementary budget of 257 million kronor was introduced for 1938/39, which empowered the Government to spend this sum on additional works of construction if a new depression developed.

In Finland, in 1934, a special budgetary equalisation fund was set up, into which sums were to be transferred for the ordinary budget during periods of trade activity. These sums, which amounted to 1,127.6 million markkaa by the end of 1938 must be invested either in gold, in a special account at the Bank of Finland, in foreign assets or, to a limited extent, in Finnish Government bonds; and they are therefore available for expenditure on public works developments during a future depression without draining funds from private enterprise.

¹ The relatively high level of total State investment in recent years is mainly due to the normal long-period development of such productive investments as railway electrification and hydro-electric and telephone expansion. The special public works undertaken to reduce unemployment have been sharply reduced since 1934/35.

Moreover, the first stages of a mechanism for international co-operation in the planning of public works have been taken through the institution of an international public works committee by the International Labour Organisation. This committee held its first session in June 1938 with the attendance of the representatives of twenty-five Governments, when a uniform scheme was adopted for information about the national public works policies in the various countries. These recent developments mark the change which has recently occurred in the attitude to the planning, timing and financing of State schemes of capital construction. But such schemes remain of little more than academic interest so long as the expenditure policies of the majority of countries continue to be determined almost entirely by the demands of rearmament.

PUBLIC DEBT

The budget deficits, which, as can be seen from the table on pages 50 and 51, have resulted from the difficulties experienced during the great depression and more recently from heavy expenditure on armaments, have naturally resulted in a growth of public indebtedness. Some examples of this development are given in the graph on page 70.

State Debt as a Percentage of National Income.

	1929	1936	1937	1938
	%	%	%	%
United States	21	53	52	58
Japan	54	79	...	(70-74)
Belgium	77 ^a	91	85	...
France	114	184	171	...
Germany	12	(22) ^b	(23) ^b	(25) ^b
Sweden	24 ^a	28	...	...
United Kingdom	174	163	152	(163)
Australia	151 ^a	178	163	...
Canada	39	78	72	...
Norway	72	67	59	...

^a 1930.

^b Exclusive of undisclosed amount of special bills.

NOTES. — Figures in parentheses are not strictly comparable. For sources of the figures of national income, see table on page 84.

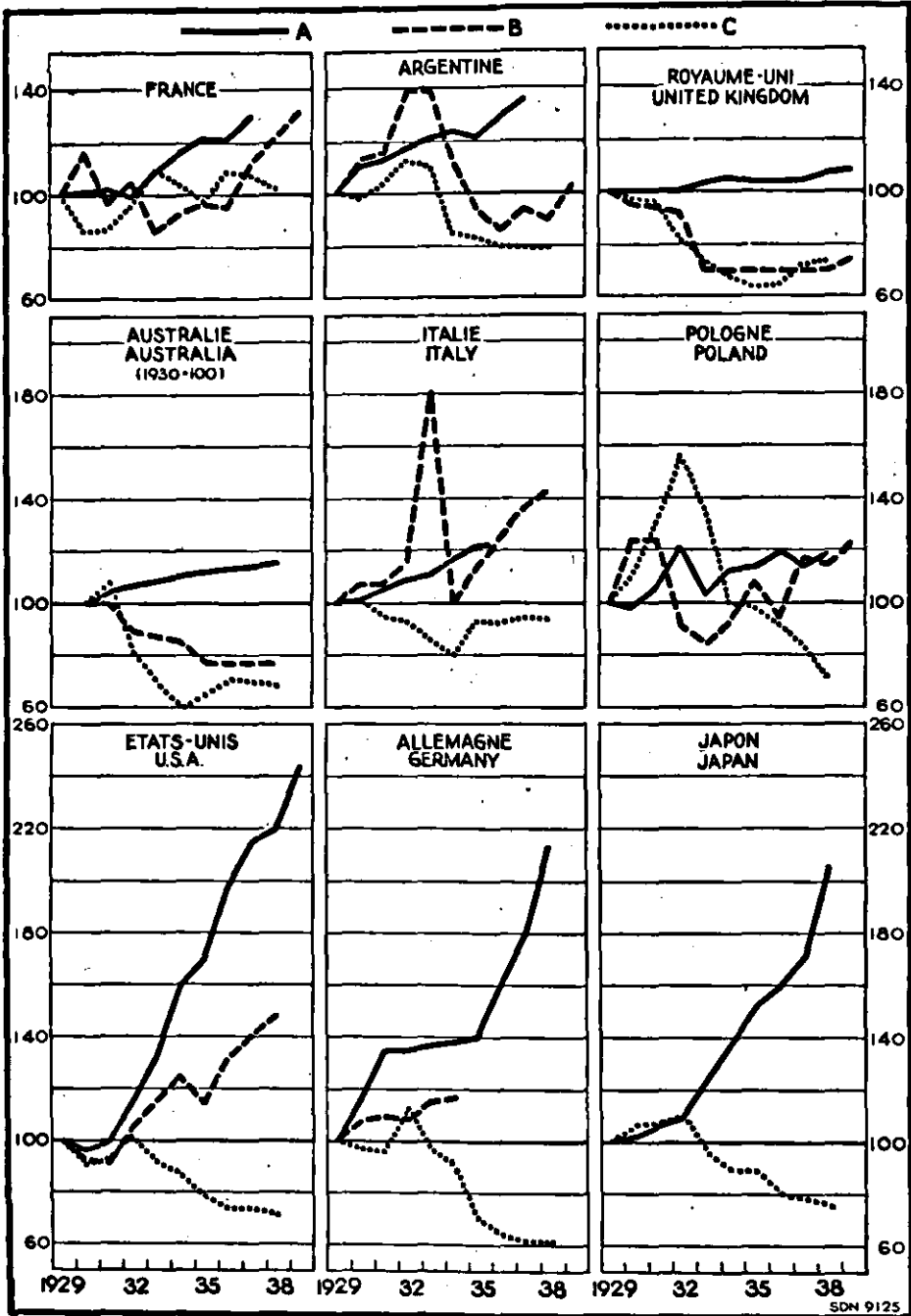
State Indebtedness.

(1929 = 100.)*

A State debt.^b

B Service of State debts.^c

C Yield on Government bonds.



* Australia, 1930 = 100.
^b France: Internal debt only.
^c The service of State debts excludes amortisation except in the case of the Argentine and France. In Australia, the figures for the debt and the service of the debt include the States and the Commonwealth.

The graph shows that there has been a particularly rapid growth of State debt in Germany, Japan and the United States. In Germany, the growth would be even greater if it were possible to include an undisclosed amount of special bills issued for the finance of rearmament and public works. In Japan, the growth of debt has been mainly caused by expenditure for rearmament and the conduct of war; and, in view of the budget deficits shown in the table on page 50, it is probable that a large increase in the Italian State debt has occurred in recent years for the same reason. The greater part of the growth of debt in the United States, on the other hand, has been due to emergency expenditures for relief, for public works and for similar purposes with the object of stimulating trade activity and employment.

While these countries show exceptionally rapid increases of debt, the general tendency of indebtedness to rise is almost universal. In every country shown in the graph, there has been some increase of debt since 1929; and, in the United Kingdom and France, for example, there have been important increases of debt in the most recent years as a result of enlarged programmes of rearmament. As the table on page 69 shows, in most cases, debt has grown more rapidly than the national income from the taxation of which the service of the debt must be financed. Although, in a number of cases, the growth of income has been more rapid than the growth of debt since 1936, the figures show an increased ratio of debt to national income since 1929 in all cases except Norway and the United Kingdom, where the growth of national income has more than offset a moderate growth of debt.

It is not possible to use this table for strict international comparisons, because both the figures of national income and those of public debt are not properly comparable; but there are certain outstanding differences. In the United Kingdom and France, the public debts represent considerably more than a year's national income, as a result of the great growth of unproductive State debt during the great war. On the other hand, the State debt of Sweden, as a result of the long avoidance of war, represents little more than a quarter of a year's income; and, moreover, this debt is backed by productive assets of an even greater value. Germany, as a result of the great post-war inflation of the mark, has removed the burden of debts of the last war; and even if allowance could be made for the undisclosed amount of special bills issued for the finance of rearmaments and public works, it is probable that the German State debt represents still a relatively moderate part of a year's national income.

While State debts have generally grown in magnitude since 1929, the cost of interest and management of the debt in most cases has not grown as rapidly. Thus, in every country shown on the graph on page 70, the payments for the service of the debt have grown less rapidly than the debt itself;¹ and, in the United Kingdom and Australia, there have been substantial reductions in the cost of servicing larger debt. There are two main reasons for this development. In the first place, the suspension of interest payments on inter-Governmental debt arising out of the great war has brought important economies to a number of countries, although these economies have been counterbalanced by reduced revenue in the creditor countries. Secondly, the reduction of interest rates has enabled States to convert their debts on favourable terms and to renew their short-term borrowing and to contract new debts on cheaper terms. For all the countries shown on the graph, except France, the yield on Government bonds, which may be taken to represent the terms on which new debts can be contracted, has been appreciably reduced since 1929.

In the case of some debtor countries, the reduction in interest rates has eased, not only the budgetary situation, but also the balance of external payments. A large proportion of the Australian external debt, for example, has been converted to lower rates of interest, which has reduced the strain on the Australian pound in the foreign exchange market. On the other hand, certain countries, such as Japan and Estonia, have relieved the burden of their external debt by repatriating a large proportion of it.

To a limited extent, further cheapening of the terms of borrowing may be expected to reduce the burden of growing indebtedness. In France, for example, financial difficulties in recent years have prevented the adoption of a policy of cheap money; but with the present efforts to rehabilitate the French finances and with the already appreciable fall in interest rates which have taken place since the autumn of 1938, important economies on the debt service may become possible. Nevertheless, in many countries, the unbroken continuation of budget deficits and so of growing indebtedness will present a serious budgetary problem in future years; and, as the graph shows, there has already been a considerable increase in the cost of service of the public debt in many countries. Moreover, the probability that there will be a decline of population in the

¹ The extraordinarily heavy expenditure on debt service in Italy in 1933 was due to the lump-sum payment of future interest on an important block of the national debt which was converted to a lower rate of interest before its due date.

countries of Western and Northern Europe and of North America¹ increases the importance of this problem. For, whereas, in the nineteenth century, the burden of State debt per head of the population was reduced by a rapid growth of the population, the opposite development is to be expected in a declining population unless the burden of debts is rapidly reduced by, for instance, repayment or a rise in prices.

RECENT DEVELOPMENTS IN CERTAIN COUNTRIES

During the period covered by the last *Survey* (summer 1937 to summer 1938) the most outstanding economic development was the onset of a serious decline of trade activity in the United States of America, which was followed or accompanied by more moderate recessions in a number of other countries. Both in the United States, in which there has subsequently been a considerable recovery in trade activity, and in the United Kingdom, where the decline of activity has been checked, this threat of trade depression has led to important changes of policy.

Recent changes in the budgetary policy of the United States have been almost entirely confined to changes in the policy of Governmental expenditure; but there have recently been two interesting changes of tax policy. The Revenue Act of 1938 introduced serious modifications into the taxation of capital gains and virtually abolished the tax on companies' undistributed profits, which had been introduced by the Revenue Act of 1936. The Capital Gains Tax imposed heavy taxation on capital gains obtained from the purchase and subsequent sale of stocks and shares and other property, without equivalent allowances for capital losses. This tax was held by many persons seriously to deter the spirit of private enterprise and the willingness to bear economic risks, and its modification was therefore widely regarded as a measure which would stimulate private enterprise. One of the intentions of the Undistributed Profits Tax, which imposed heavy taxation on that part of business profits which was not distributed in dividends to shareholders, had been to stimulate business by increasing the demand for consumption goods. But many critics urged that this tax also deterred capital development by private companies, since the conditions in the capital market were not such as always to allow private companies to borrow by the issue of new stocks and shares the sums which they needed for development and which they might have obtained by the accumulation of their own profits.

¹ See Chapter VI.

The main interest of recent budgetary development in the United States is due to changes in the policy of public expenditure. As the following figures show, total Governmental expenditure and the consequent budget deficits rose to a high level in 1935/36, and were reduced appreciably for 1936/37 and still more substantially for 1937/38. Moreover, as the preliminary estimates for 1938/39 showed, it was at first intended to reduce State expenditure and the budget deficit still further.

United States: Government Expenditure and Budget Deficits.

\$ (000,000's).

	1935/36	1936/37	1937/38	1938/39 (estimate of January 1938)	1938/39 (revised estimate)	1939/40 (estimate of January 1939)
Total expenditure ^a . . .	8,643	8,409	7,626	6,869	9,492	8,995
Total revenue	4,115	5,307	6,242	5,919	5,520	5,669
Budget deficit ^a	4,528	3,102	1,384	950	3,972	3,326
Special social security issues	19	560	1,022	...	...	...
Deficit minus social security issues	4,509	2,542	362	...	...	...

^a Excluding amortisation of debt.

As a result of the recession in trade activity which developed in the autumn of 1937 and which was ascribed by many writers in large part to a too rapid reduction in the Government deficit, a new policy of spending and lending for recovery was announced in April 1938; and this change of policy is revealed in the revised estimates for 1938/39 and in the preliminary estimates for 1939/40.¹

¹ For a more detailed analysis of the effect of reduced State expenditure upon American trade activity, cf. *World Economic Survey, 1937/38*, Chapter I. As was shown in that chapter, the figures for the budget deficit underestimate the true change in the position since 1935/36. For, under the social security legislation of 1936, certain new taxes and contributions levied on wages and on employment have been in large part accumulated in special trust funds for the future payment of unemployment benefit and old-age pensions. These accumulations have the same immediate economic effects as an equivalent diminution of the budget deficit; but, as a result of the methods of book-keeping which have been adopted, they do not reduce the budget deficit as published. These accumulations of funds are invested in special social security issues of Government securities; and the last two lines of figures in the above table show how important these accumulations have been in reducing the "true" budgetary deficit.

Great stress is being laid in the United States upon the stimulation of economic activity by means of a high level of Government expenditure, combined with a monetary policy designed to preserve a plentiful supply of funds for private investment. One objective of this policy is to regain budgetary equilibrium, not by raising rates of taxation and by reducing expenditure, but by raising the national income, so that increased yields of existing taxes may cover the present deficits. In his budget message to Congress of January 1939, President Roosevelt estimated that, at existing rates of taxation, total revenue would vary in the following way with variations in the national income :

Total national income	\$ (000,000's).	Estimated revenue at present rates of taxation
70,000		6,000
80,000		8,000
90,000		10,600

On the basis of such estimates, a rise in national income from its estimated level of \$63,993 million in 1938 to some \$80,000 million would be necessary to cover the present level of State expenditure.

In the United Kingdom, the finance of rearmament has overshadowed all other questions of public finance since the declaration of the Government in February 1937 that it intended to spend a total sum of £1,500 million in the course of the next five years and to borrow £400 million of this amount. This policy of raising annual expenditure on armaments to an average level of £300 million a year (from an average level of £122 million between 1929 and 1936) has been greatly changed within the last year. In February 1939, legislation was introduced to raise the limit of borrowing for rearmament from £400 to £800 million; and it has been estimated that some £630 million¹ will be spent on national defence, including measures of passive civilian defence, in the single year 1939/40.

In the course of the development of this rearmament programme, not only has the total expenditure on arms been greatly increased, but a rising proportion of this expenditure has been met, not from current budgetary revenue, but from the proceeds of loans, as the following figures show.

In 1937/38 and 1938/39, efforts were made to finance a large part of the enhanced cost of rearmament from current revenue. In 1937/38, a special national defence contribution was imposed, which took the form of a 4% to 5% tax on business profits; the standard rate of income tax was raised

¹ This estimate was raised to some £750 million in July 1939, of which about £500 million is to be borrowed.

United Kingdom: Expenditure on National Defence.

	1928/29	1937/38	1938/39	1939/40 Esti- mates
	£ (000,000's).			
Total expenditure on national defence ^a	113	266	400	628 ¹
Of which:				
(a) Financed by loan	—	65	128	380
(b) Financed from budget revenue .	113	201	272	248

^a Including pensions and expenditure on civil defence of £3.5 million in 1937/38, £17.9 million in 1938/39, and £56.5 million in 1939/40.

from 4s. 9d. to 5s. in the pound; and the duties on petrol and oil and on tea were also raised. In 1938/39, the standard rate of income tax was further raised to 5s. 6d. in the pound.

For 1939/40, certain further tax increases were announced, including increases in the surtax, in the tobacco and sugar duties and in the taxation of motor-cars. But although total expenditure on armaments was expected to rise by £228 million, the amount to be covered by revenue was to be reduced by £24 million, leaving an additional £252 million to be covered by borrowing. The change in policy was appropriate to the change in economic circumstances. For, in the spring of 1937, when the large programme of rearmament was started, trade was active and an actual speculative boom of commodity prices had developed. In the spring of 1938, a recession in trade had made itself felt, but it was not yet clear whether this recession in activity was serious. By the spring of 1939, although the downward movement of trade activity had been arrested, yet business seemed to be stabilised at a comparatively low level with a considerable degree of economic resources unemployed. In such circumstances, it was decided to finance a great part of the abnormally high Government expenditure by increased borrowing rather than by the raising of fresh taxation.

In France also, the public finances have been overburdened by the cost of rearmament, which has been the most important cause of the continuation of large budget deficits. In a report issued in November 1938,² the French Premier and Minister of Finance assessed the total public deficit on the basis of the current rates of taxation and expenditure as follows:

¹ This estimate was raised to some £750 million in July 1939, of which about £500 million is to be borrowed.

² See *Journal officiel*, November 12th, 1938.

France: Estimated Public Revenue and Expenditure, 1939.

Francs (000,000's).

	Current revenue	Expenditure	Deficit
State general budget	56,000	64,500	8,500
State extraordinary budget	—	29,500	29,500
Caisse autonome d'amortissement	7,500	7,500	—
Local authorities	22,000	24,000	2,000
Deficit and maintenance of railways	—	6,000	6,000
Public works of local authorities and colonies	—	5,500	5,500
Total	85,500	137,000^a	51,500

^a This total public expenditure of 137,000 million francs would represent almost 55% of the national income, estimated, in the opinion of M. Daladier and M. Reynaud, on the most optimistic calculations, at 250,000 million francs.

In all, they estimated, 55,000 million francs would have to be borrowed when allowance had been made for certain other items. The importance of rearmament in bringing about this deficit can be realised from the fact that such expenditure accounted for 39,500 million francs of the total estimated State expenditure. If expenditure on national defence could be reduced to the figure of 10,800 million francs at which it stood in 1934, the total need for borrowing could thereby have been reduced from approximately 55,000 to 26,000 million francs.

In May 1938, M. Daladier had already taken some measures to reduce the budgetary problem to more manageable dimensions. At that date, practically all direct and indirect taxes had been raised by 8%; but the whole of the additional revenue expected from this measure had been absorbed by additional credits opened for rearmament purposes. At the end of 1938, further measures were taken. Important economies, expected to save some 5,000 million francs in 1939, were imposed by the decision to postpone expenditure on public works and to set up a committee to propose further economies. Moreover, measures were taken to raise an additional 8,750 million francs in taxation, of which 4,250 was to be raised by indirect taxes, including a 2% tax on wages and all other earned incomes. Allowing for an increase of some 5,000 million francs as a result of the economic recovery to be expected from the operation of all the planned reforms, the prospective public deficit was reduced from 55,000 to 35,000 million francs. In March and

April 1939, further action on these lines was taken, largely as the result of a decision greatly to increase expenditure on national defence. Further economies were effected through reduced expenditure on public works, the retirement of surplus officials, increased control over municipal expenditure, and the withdrawal of treasury subsidies to industrial alcohol and wheat; and a special 1% "armaments tax" was imposed on all payments.

This policy of increased taxation and reduced expenditure is sharply contrasted with the policies of increased borrowing for increased expenditure which have been adopted by the United States and the United Kingdom in view of the recession of trade activity in 1938. But the contrast must not be exaggerated; for, in France also, measures have been adopted with the object of stimulating expenditure on capital development in view of the depressed state of trade. Certain monetary measures of this nature will be referred to in the next chapter; but a number of taxes have also been modified with this object in view. Thus, decrees have been issued to reduce the registration fee on increases of capital and the tax on debentures issued to finance renewals or extensions of plant, to exempt from income tax the interest on certain loans raised to finance foreign trade and for business developments, to suspend the automatic increase in certain taxes which would otherwise have followed upon an increase in the number of workers employed, and to exempt from income tax profits from the sales of assets if these sums are promptly reinvested within the business concerned.

But the fact remains that, whereas, in the United States and the United Kingdom, deficits have recently been increased, the French Government has made serious efforts to reduce the existing deficits. The difference of policy can largely be explained by the differences in the economic situation. The French economy has recently been suffering from a crisis of confidence on the part of private businessmen, which has been in large part due to the prospect of continuing budget deficits on a high level. A reduction of such deficits was necessary to restore confidence. Moreover, in the depression of the French economy, unemployment is much less important than in the United Kingdom or the United States. It has been estimated,¹ for example, that France in the autumn of 1938 had only about 8% of her workers unemployed, whereas almost 10% of the workers in the United Kingdom were unemployed even in 1937 during the best months since the post-1929 depression. French industrial

¹ Cf. the report issued by M. Daladier and M. Reynaud; *Journal officiel*, November 12th, 1938.

production was low in 1938, being 23.1% below the 1929 level while industrial production in the United Kingdom in the same year was 15.7% above the 1929 level. Thus the low level of French production was not essentially a problem of unemployment. For its cure and for the promotion of the programme of rearmament, a general stimulation of demand brought about by increased Government expenditure financed by reflationary monetary measures was, therefore, less appropriate than measures such as the modification of the forty-hour week, which would allow the existing resources to produce on a larger scale, and the reduction of expenditure on public works, which would release resources for the extension of the rearmament programme.

The Union of Soviet Socialist Republics also shows in recent years a very large increase in expenditure on national defence; such expenditure rose from 3.7% to 20.7% of the total budgetary expenditure between 1934 and 1937. As the following figures show, this increase in expenditure on national defence has at the same time been accompanied by large increases in budgetary expenditure on social and cultural services and under the heading "national economy", which represents in

Budget Accounts of the Union of Soviet Socialist Republics.

Roubles (000,000's). — Estimates in italics.

	1928/29	1935	1936	1937	1938
Expenditure:					
National economy . . .	4,687	<i>35,157</i>	<i>37,584</i>	<i>39,586</i>	...
Social and cultural . . .	.	<i>4,804</i>	<i>6,510</i>	<i>10,870</i>	...
National defence . . .	.	<i>6,500</i>	<i>14,816</i>	<i>20,102</i>	...
Other expenditure . . .	.	<i>18,940</i>	<i>19,805</i>	<i>26,562</i>	...
Total expenditure . .	8,105	<i>65,401</i>	<i>78,715</i>	<i>97,120</i>	<i>131,138</i>
Receipts					
From socialised economy	6,169	<i>56,225</i>	<i>69,919</i>	<i>87,772</i>	...
From the population . .	806	<i>2,183</i>	<i>2,130</i>	<i>2,645</i>	...
Other receipts	389	<i>3,078</i>	<i>1,516</i>	<i>1,677</i>	...
Total receipts, excluding the proceeds of loans . .	7,364	<i>61,486</i>	<i>73,565</i>	<i>92,094</i>	<i>124,908</i>

the main the large sums which have been allocated for the planned capital development of State industry.¹

In the absence of any reservoir of unemployed labour or unused capital resources, the heavy expenditure on national defence involved the use of resources which could otherwise have been applied either to raising standards of living or to intensifying still further the pace of capital construction. But the financial problems involved are peculiar in the Union of Soviet Socialist Republics, where practically the whole of productive enterprises are socialised. As the revenue figures of the Soviet Union show, the rapid increase in expenditure has involved very little State borrowing. For the receipts of the budget are composed almost exclusively of revenue obtained from socialised industry, which takes the form either of a turnover tax² or of direct deductions from profits. Since industry is socialised, such levies can be increased without fear that the incentive to produce will thereby be diminished.

As the above figures show, the total funds passing through the budget have shown a 1,100% increase since 1928/29. This is to be explained in the main by three factors. In the first place, there has been a very substantial increase in total production and in total real income as a result of the large schemes of industrial development and of capital extension. Thus, in 1937, the index of industrial production was 324% above the 1929 level; and the real national income in 1937, after making allowances for changes in prices, was 231% above the 1929 level. This increase of real production accounts for a more or less corresponding increase in the revenue from the socialised economy and in certain personal taxes. Secondly, since 1929, there has been a considerable extension of socialisation until virtually the whole of the economy has been brought under State ownership or control; and, for this reason, a larger proportion of the national income passes through the State budget. In the third place, there has been a rise of prices; but statistics are not available to measure the extent of this rise. Some part of this rise of prices is to be ascribed to the abolition of rationing for consumption goods, which was carried out between 1934 and 1936. This change involved raising the prices of rationed supplies towards the prices of supplies which were not

¹ It has been estimated (L. E. HUBBARD, *Soviet Money and Finance*, Chapter XI) that, in 1934, some 53% of the budgetary expenditure on national economy was allocated for capital construction, and that this represented some 70% of the total of the funds to be used for capital investment. The remaining 30% was to be financed by profits of State enterprises which did not pass through the budget.

² In 1937, for example, the receipts from the turnover tax represented as much as 87.5% of the revenue from the socialised economy and 83.4% of the total revenue, excluding the proceeds of loans.

subjected to such control; and, at the same time, wage-rates were raised by amounts varying between 5% and 30% to compensate for the higher cost of living. This involved, not only a direct rise in the prices of those consumption goods which had previously been rationed, but also a rise in the price of other commodities, which had to be priced in the future on the basis of a higher wage cost.

The public finances of Italy, Japan and Germany in recent years have been even more dominated by the problem of raising funds for expenditure on rearmament or on the actual conduct of military operations than in other countries. In a speech delivered in May 1938, the Italian Minister of Finance estimated that 36,000 million lire of emergency expenditure had been incurred between July 1934 and March 1938; and the budgets and budget estimates for the three years 1935/36 to 1937/38 show a total deficit of 42,445 million lire, which represents 37.3% of the total expenditure of those three years. Certain special revenues have been raised during these years. A compulsory loan in October 1936 raised simultaneously with a special tax on real property yielded 7,500 million lire; a special 10% levy in October 1937 on the capital of joint-stock companies is calculated to have yielded 3,300 million lire; and a special levy in November 1938 on the capital of private business is estimated to yield 1,200 million lire.¹ A further sum of 1,376 million lire was obtained from the revaluation of the Italian gold reserves, and 513 million lire was raised in gifts of gold to the Italian Government. Certain sums have been obtained from the sale of foreign assets which were to be handed over to the Italian Government in exchange for Government obligations; and other receipts have included the proceeds of borrowing on long and short term, advances from the Cassa dei Depositi e Prestiti (which makes available to the Government the assets of savings banks, of Post Office savings banks and of the officials' insurance institute) and the issue of 10-lire Treasury notes.

In May 1938, the Minister of Finance foreshadowed the balancing of the budget by gradual stages within three years; but, in May 1939, he stated that this hope must be abandoned. For ordinary expenditure, originally estimated at 25,035 million lire for 1938/39, was expected to rise to 32,000 millions in 1939/40 as a result of increases in civil servants' pay, events in Albania and fresh military expenditure.

In Japan, the war against China has led to very great increases of expenditure, and the estimated budget deficits for

¹ These estimates are given by the Minister of Finance in an article in a special supplement of the *Financial Times*, January 12th, 1939.

1937/38 and 1938/39 amount to 8,600 million yen, which represents 64.5% of the total expenditure for these two years. Certain increases of taxation have taken place which are estimated to yield 450 million yen in 1937/38 and a further 264 million yen for 1938/39, but these sums are small in comparison with the total deficits.¹ Increased taxation, together with measures for rationing consumption goods and for quantitative restrictions of the supply of labour and raw materials for uses other than those which are essential for the war, has helped to release resources for the promotion of war activity. The rationing both of consumption goods and of labour and materials for certain branches of industry has also made available certain funds which have enabled a part of the issues of Government bonds to be taken up by private individuals and private concerns; and this increase of private savings has been promoted also by a national thrift campaign, which, in certain cases, has made it compulsory to save a certain proportion of income. But, as will be seen in the next chapter, by far the greater part of the issue of Government bonds by which the deficit has been financed has been taken up by the banks.

In Germany, the finance of public works and of rearmament has been the outstanding feature of internal economic developments since 1933.

In the first years of this development, State activity could be extended by drawing upon the large reservoir of unemployed resources of men and equipment which existed at the bottom of the depression in 1933. But, since 1937 and 1938, virtually full employment of all available real resources has been achieved. As in Japan, a policy of rationing both consumption goods and labour and materials for inessential private uses has been progressively adopted; and this has both released resources for employment by the State and, together with a thrift campaign, has made available for the purchase of Government loans those funds which cannot be spent freely in view of quantitative restrictions upon purchases.

There have been certain increases in taxation. In particular, the Corporation Tax was raised for a second time in the summer of 1938; a number of local taxes were appropriated by the State; a fine of 1,000 million marks was imposed upon the Jews in November 1938; and certain exemptions and abatements of the income tax were removed in February 1939. In March 1939, in connection with the introduction of a new method of financing the budget deficit (*cf.* Chapter III), it was announced that an

¹ *Cf.* Dr. W. TOMBERG: "Die Japanische Kriegsfinanzierung", *Der Deutsche Volkswirt*; January 13th, 1939.

additional income tax would be imposed on increases of taxpayers' income between 1938 and 1939. Moreover taxes have been collected with greater stringency. But, in the main, three sources have been used for the increased State expenditure on public works and rearmament. In the first place, there has been a great increase in tax revenue, owing to the recovery in trade activity since 1933. While the rates of taxation have been maintained at the crisis-level ruling in that year, the taxable national income has greatly increased. Secondly, the reduction, and indeed the virtual abolition of unemployment, has both reduced State expenditure on unemployment relief, and also has increased the income of the Reich Labour and Unemployment Insurance Office. Thirdly, important sums have been raised by borrowing. No official figures of State expenditure have recently been published;¹ but it has been estimated that the receipts of public authorities in 1938, including all taxes, dues and Customs, the increase in the published debt, the revenues of the local authorities, the proceeds of contributions to various State insurance funds, contributions to the German Labour Front and the Winter Relief Fund, amounted to RM35,800 million which represents 47.1% of the national income estimated at RM76,000 million.² These figures do not, apparently, make any allowance for the special levy on industry for the subsidisation of exports, for any increase in the undisclosed debt, for the budget of the National-Socialist Party or for any part of the special levy of RM1,000 million imposed upon the Jews.

¹ The order of magnitude of additional State expenditure in the years since 1933 may be judged from various unofficial estimates which have been made.

In an article published in the *Annalist*, January 18th, 1939, the following estimate has been made of the funds available for extraordinary expenditure during the five years ending March 1938:

	RM (000,000's)
Increase in current revenue	23,000
Savings on unemployment relief	7,400
Increase in published debt	7,500
Increase in unpublished debt.	15,000
Total	52,900

A similar estimate has been published in an article in the Foreign Policy Report of October 1st, 1938, for total "extraordinary" expenditure during the three years ending March 1938:

	RM (000,000's)
Increase in current revenue and savings in unemployment relief	20,000
Increase in published and unpublished debt	15,000
	35,000

² Reichskreditgesellschaft: "Germany's Economic Position at the Turn of 1938/39".

Estimates of National Income. (In national currencies, 000,000's.)

Countries	Currencies	1929	1930	1931	1932	1933	1934	1935	1936	1937	1938
Australia*	A.£	768	730	566	528	550	609	632	704	774	814
Austria	Sch.	7,419	7,633	7,304	6,362	5,675	5,693	5,748	...	...	...
Belgium	B. fr.	...	68,490	...	50,000	...	49,710	...	60,200	65,920	...
Bulgaria	Leva	56,207	48,641	44,561	39,273	35,633	34,564	36,569	...	...	...
Canada	C. \$	5,867	5,165	4,180	3,379	3,221	3,574	3,787	4,133	4,576	...
Czecho-Slovakia*	Koruna	90.0	79.2	68.4	58.1	53.6	56.2	58.4	59.6	66.7	...
Denmark	Kr.	3,700	3,750	3,550	3,400	3,550	3,850	4,050	4,200	...	...
Estonia	E. Kr.	342	315	260	224	249	259	284	318	...	...
Finland*	Mk.	18.3	16.6	13.8	13.9	15.2	17.9	18.8	20.5-21.0	...	...
France*	Fr.	245	243	229	206	199	184	172	189	212	(250)
Germany	RM.	75,949	70,223	57,458	45,175	46,514	52,710	58,622	64,940	70,972	76,000
Greece*	Drachma	41	37	30	...	...	...	...	...	...	...
Hungary*	Pengö	5,899	5,507	4,691	4,005	3,698	3,545	3,662	3,988	4,417	4,705
Ireland	£	161.7	...	150.8	145.5	140.1	143.8	149.2	...	...	...
Japan	Yen	11,918	10,470	10,043	10,229	11,469	12,029	12,482	13,109	...	(18-19,000)
Netherlands	Fl.	5,768	5,525	4,787	4,320	4,283	4,187	4,141	4,239	4,500	4,700
New Zealand ^b	N.Z. £	176.7	171.2	152.6	135.5	130.0	147.6	152.5	168.0	197.8	215.0
Norway	Kr.	2,200	2,197	1,994	1,934	1,902	1,954	2,076	2,306	2,637	...
Poland*	Zloty	28.3	...	...	...	15.5	...	...	...	...	...
Roumania*	Lei	201	150	110	103.5	99.3	...	...	...	...	...
Sweden	Kr.	...	7,630	6,926	6,400	6,454	7,262	7,800	8,591	...	...
Switzerland	S. fr.	10,665	10,601	8,898	7,489	6,890	6,500	...	...	...	...
United Kingdom	£	4,384	4,318	3,889	3,844	3,962	4,238	4,530	(4,850)	(5,200)	(5,000)
United States	\$	82,691	69,104	54,249	40,089	42,504	50,611	55,794	65,226	71,853	63,993
U.S.S.R. ^c	R.	28,900	...	...	45,500	48,500	55,800	65,700	83,100	95,700	(112,000)
Yugoslavia*	Dinar	69	...	...	32	...	...	37.5	...	44.2	...

NOTE. — Figures in parentheses are not strictly comparable. * Milliards. ^a Year beginning July 1st. ^b Year beginning April 1st. ^c At 1926/27 prices.

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Chapter III.

THE MONEY AND CAPITAL MARKETS¹

THE SUPPLY OF MONEY

The years 1937 and 1938 witnessed both the turning-point from economic recovery to renewed recession and also a state of increasing tension in international politics, which culminated in the events of September 1938. But one of the most striking features of the period covered by this *Survey* has been the absence of any monetary stringency in spite of these economic and political developments, both of which have frequently in the past been accompanied by a marked rise of interest rates.

Great liquidity was maintained in all the principal financial markets; and, in consequence, the recession which started in the middle of 1937 was not intensified, as had been the case in 1929 and 1930, by monetary deflation. In practically no country were any deliberate measures of monetary restriction undertaken; and the continuation of a policy of cheap and abundant monetary supplies assured one of the necessary conditions for a prompt recovery. Two important monetary developments since 1929 have made this change of monetary policy possible. In the first place, as will be seen in a later section of this chapter, the value of monetary gold reserves has been greatly increased in a number of countries, both through increased quantities of such reserves and also through the revaluation of gold reserves at higher prices in terms of the different national currencies. Secondly, the abandonment of the international gold standard, the institution of exchange stabilisation funds and, in some countries, the rigid control of the foreign exchanges have enabled the national monetary authorities to adopt policies of internal monetary expansion with less regard to possible repercussions upon their balances of payments with other countries.

Perhaps the most notable test of the liquidity of different financial structures was experienced during September 1938, when the fear of imminent war in many countries led to a large

¹ Cf. *League of Nations, Money and Banking, 1933/39, Volumes I and II.*

ncrease in the demand for notes and currency. As the following figures show, the demand for notes increased sharply during

Bank-notes and Deposits in the Autumn of 1938.

(August 1938 = 100.)

	Note circulation at end of:		Commercial bank deposits at end of:	
	September	November	September	November
Canada	115	108	102	104
Denmark	108	104	102	104
Finland	106	100	97	95
France	126 ^a	108	86	96
Germany	116	112	100	104
Hungary	141	133	90	95
Lithuania	119	115	91	100
Poland	126	114	90	97
Roumania	111	109	86	99
Sweden	112	101	102	101
Union of South Africa	112	101	102	107
United Kingdom	104 ^b	100	99	98
Yugoslavia	119	109	95	97

^a September 29th.
^b September 28th.

September 1938; and this caused a drain of cash from the commercial banks, whose deposit liabilities fell considerably in a number of countries, such as France, Hungary, Lithuania, Poland and Roumania. By the end of November, the demand for notes had fallen again to some extent, although, in the majority of countries, it remained above the August level; and, as a result of the repayment of these notes, the deposits of the commercial banks had risen again in most countries practically to their previous level.

These events had, however, a remarkably small effect upon the different money markets. There does not seem to have been a single bank failure of any consequence during 1938; the rise in interest rates was generally very moderate and was quickly reversed again; and the Bank of France was the only central bank to raise its discount rate in September 1938. Moreover, as the above figures show, the decline in commercial bank deposits during September 1938 was in most cases moderate, although the drain of cash from these banks tended to reduce their cash reserves considerably. The abnormal demand for cash was met in part by a reduction in the cash reserve ratios of the commercial banks and by the reduction of the banks' reserve balances with the central banks. In a

number of cases, the central banks extended freely their advances of money through additional loans and discount facilities to the commercial banks. To some extent, the additional supply of notes was provided by the abnormal expenditure of Governments upon measures of mobilisation, financed through Government borrowing from the central banks or through the reduction of Government balances with the central banks.

In most countries, there has been a considerable increase in total monetary supplies since 1929, as the following figures show. For all the countries shown in the table except Poland,

The Supply of Money.

(End of 1929 = 100.)

	Notes in circulation at end of:		Total commercial bank deposits at end of:	
	1937	1938	1937	1938
Australia	117	119	109	132
Brazil	134	142	149	197
Chile	201	226	154	155
Denmark	114	120	112	116
France	135	160	89	99
Germany	102	148	67	77
Hungary	93	172	86	81
Italy	104	112.5	77	80.5
Japan	140	178	134	164
Norway	141	150	92	...
Poland	75	100	60	68
Sweden	172	186	115	122
United Kingdom	137	137	130	127
United States	176	179	95	98
Yugoslavia	100	119	64.5	63

the total note circulation has risen since 1929. In many cases, the total supply of deposit money is also greater than in 1929; and, in a number of the countries in which deposits have not yet regained the 1929 level, the increase in the supply of notes has been considerably larger than the fall in the supply of deposit money. But, in practically all the countries shown in the above table, the note circulation has grown relatively to the supply of deposit money since 1929. This increased preference for cash is due to a number of factors, including a lingering fear of bank failures as a result of memories of the financial crises of 1931 and 1932, the reduction in interest rates that can be earned on deposits, and the increased desire for liquid currency in times of political tension. The increase in monetary supplies continued

in most countries during 1938. The note circulation increased during 1938 in all the countries shown in the above table, except the United Kingdom, and the supply of deposit money increased in all the countries shown, except Hungary, the United Kingdom and Yugoslavia.

These increases in monetary supplies have not taken place at the expense of the liquidity of the different banking systems. As the following figures show, the cash reserve ratios both of central banks and of commercial banks have increased in a number of countries since 1929.

Bank Reserve Ratios.

	Gold reserves as a ratio of total note circulation and central bank sight liabilities			Cash reserve ratios of commercial banks		
	1929 %	1937 %	1938 %	1929 %	1937 %	1938 %
Chile	13.2	14.5	13.6	18.0	19.3	...
France.	47.4	53.4	62.0	15.8	25.2	...
Germany.	36.7	1.0	0.7*	4.6	4.6	...
Japan	47.2	27.6	14.0*	11.3	8.6	...
Netherlands	49.9	84.1	79.8	6.9	21.1	...
Sweden	29.0	30.6	37.0	3.7	15.3	14.1
Switzerland	49.6	85.1	84.6	2.7	13.1	...
United Kingdom	27.4	48.3	49.4	12.9	11.2	11.3
United States	64.8	102.5	96.4	12.7	35.5	...

* Provisional.

* Excluding gold and foreign assets of former National Bank of Austria.

In Germany and Japan, central bank reserve ratios have declined seriously; but, in these countries, the rigid control of foreign exchange transactions has prevented this from causing any strain on the internal monetary systems. In Japan, the reserve ratio of the commercial banks has also declined.

The widespread increase in banking liquidity has been due primarily to large increases in the value of monetary gold reserves. Total monetary reserves have risen greatly in quantity, largely as a result of a considerably higher level of gold production. As the following figures show, this increase in the volume of gold reserves and of new gold production continued in 1938.

Since 1929, however, the monetary value of gold reserves has been greatly increased by the devaluation of national currencies and the revaluation of central bank gold reserves. This process of revaluation has continued in every year since the revaluation of the gold reserves of the United States at

the beginning of 1934.¹ By March 1939, some 90% of the world's monetary reserves had been revalued.² In the course of 1938, monetary gold reserves were revalued in Finland, Mexico and Uruguay; and, in November 1938, the French gold reserves were revalued for the third time since 1936. Early in 1939, revaluations took place in Hungary and Estonia.

World Gold Supplies.

\$ (000,000's) of old gold content.

	1929	1937	1938
Central monetary gold reserves of the world ^a (end of year). . . .	10,252	14,078	14,775 ^b
Annual world ^a gold production . . .	385	611	651

^a Excluding the Union of Soviet Socialist Republics, whose monetary gold reserves increased from 147 to 225 million dollars of old gold content between 1929 and 1935, and whose gold production is estimated to have risen from a figure of 18 to 22 million dollars in 1929 to between 92 and 120 million dollars of old gold content in 1935.

^b Excluding the reserves of the Bank of Spain.

The most important development of this kind in recent months was the revaluation of the gold reserves of the Bank of England in February 1939. In January 1939, gold amounting to £200 million at the old statutory price had been transferred from the Bank of England to increase the gold reserves of the Exchange Equalisation Account; and, in order to offset the effect which this transfer would otherwise have had upon the note issue, the fiduciary issue of notes had been raised from £230 million to £400 million. The revaluation of the gold reserves of the Bank of England in February increased the book value of these reserves by some £95 million, and the fiduciary note issue was reduced to £300 million. The book profit from the revaluation of the gold reserves was used to increase the sterling assets of the Exchange Equalisation Account. These transactions were in effect so arranged as to preserve the total note issue practically unchanged, but to increase the gold and sterling reserves of the Exchange Equalisation Account.³

THE CAPITAL MARKETS

As a result of the prevailing conditions of monetary liquidity, to which reference has been made above, the cost of borrowing in short-term and long-term capital markets has remained low

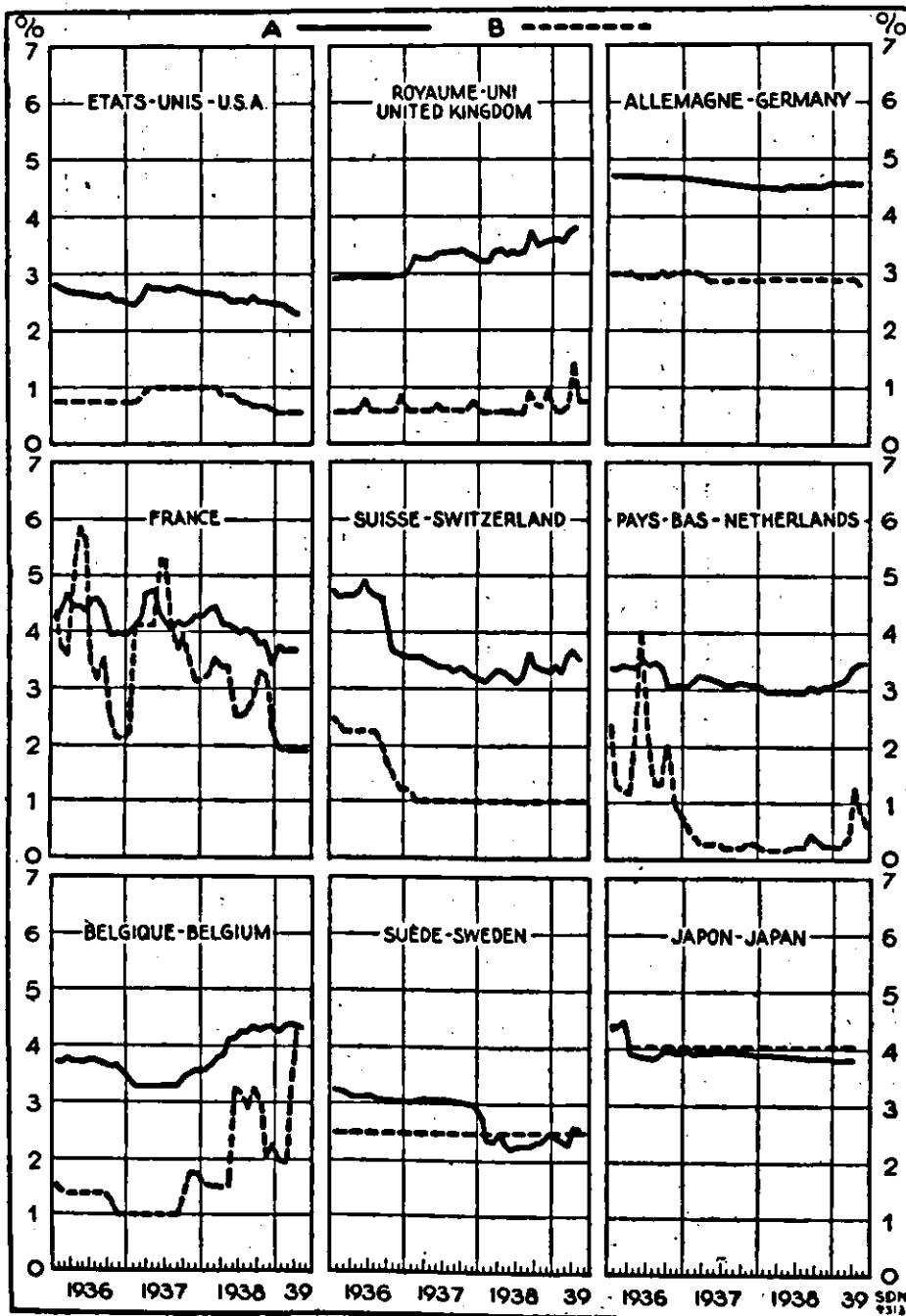
¹ Cf. the table on pages 36 and 37 of Vol. I of the League of Nations *Money and Banking, 1938/39*.

² Excluding the Union of Soviet Socialist Republics, for which no recent information is available. Cf. Ninth Annual Report of the Bank for International Settlements.

³ In July 1939, some £20 million of gold was retransferred from the Exchange Equalisation Account to the Bank of England as a backing for the additional holiday demand for notes. Seasonal increases in the demand for notes had been met by increases in the fiduciary issue in December 1937 and 1938.

Long-term and Short-term Interest Rates.

A: Percentage yield of Government bonds.
B: Market rates of discount.



or has been further reduced in the majority of countries. Some illustrations of the movements of interest rates are given in the graph on page 90.

In France and the United States of America, there has been an appreciable fall in interest rates since the first half of 1937. In the United Kingdom, for reasons which will be discussed in a later section, there was a moderate rise of long-term interest rates during 1938 and the first months of 1939. In Belgium, however, the rise in short-term and long-term interest rates has been more marked. After the devaluation of the French franc to 179 francs to the pound in May 1938, there was a considerable outflow of funds from Belgium. In order to preserve the value of the Belgian franc, which is one of the few currencies which still operates on a free gold standard, an orthodox policy of monetary restriction has been adopted. The National Bank of Belgium raised its discount rate from 2% to 4% in May 1938, and various measures of credit restriction were imposed. The rate was, however, reduced quickly again to 3%, and, in October 1938, was lowered to 2½%. But, in April 1939, to meet renewed external strain on the currency, the rate was raised again to 4%, and was subsequently lowered to 3% when the strain had been relieved. In July 1939, it was further reduced to 2½%. These measures have resulted in a general hardening of interest rates in Belgium.

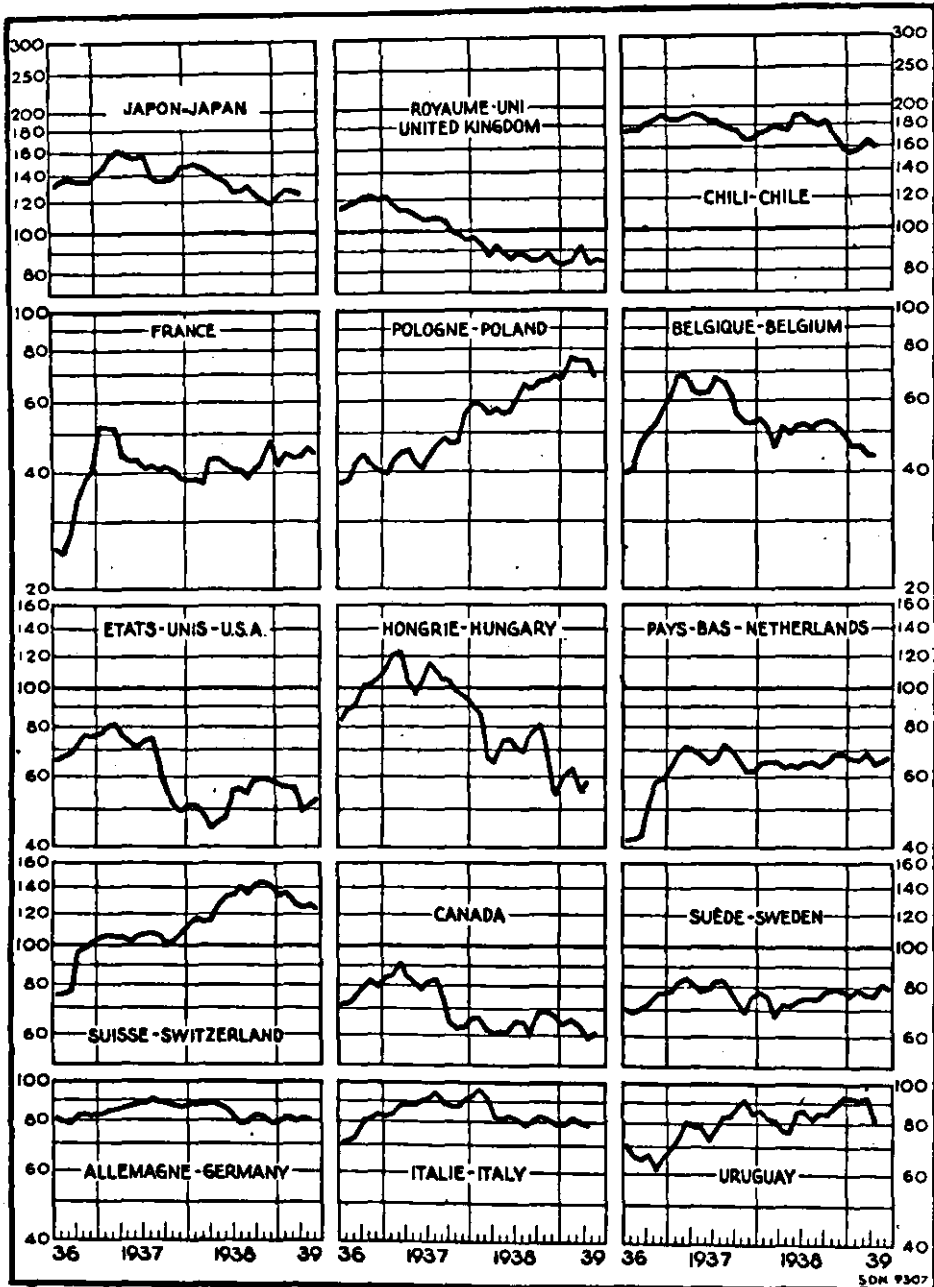
A certain number of agricultural countries, such as the Argentine, Australia, India and New Zealand, lost reserves of gold or of foreign exchange during 1938 as a result of the decline in the prices obtained for their exports. Although, as will be seen later, many of these countries took measures to offset the internal deflationary pressure which such a development would otherwise have caused, there was some rise in interest rates, which was particularly marked in New Zealand, where the official rate of discount was raised from 2% to 4% towards the end of 1938. But in spite of these few instances of higher interest rates, the continuation of a general policy of cheap money is illustrated by the fact that, of twenty-five European central banks, five reduced their discount rates and nineteen had discount rates unchanged during 1938, while only one — the National Bank of Belgium — raised its discount rate in the course of the year.¹

This comparative stability of interest rates in most countries has maintained the price of Government bonds and of other high-grade fixed-interest securities; but the prices of industrial shares declined in many countries between 1937 and 1938, as the graph on page 92 shows.

¹ Cf. Ninth Annual Report of the Bank for International Settlements, page 92.

Market Value of Industrial Shares.

(1929 = 100.)



In the majority of countries, this was the natural result of the decline in profit expectations which resulted from the recession in business activity after the middle of 1937; and, in some cases, the downward movement has been intensified by the increasing political uncertainty. In a number of countries, such as Canada, the United States, the Netherlands and Sweden, there was an appreciable recovery of share prices after the middle of 1938, but in many cases there was a renewed decline in share prices during the first months of 1939. In some countries, and notably in the United Kingdom, the fall in share prices continued throughout 1938.

In Poland, as can be seen from the graph, share prices continued to rise markedly throughout 1937 and 1938, largely as a result of the sustained increase in industrial activity which has resulted from the large programme of Government capital expenditure.¹ But the decline in share prices has been marked in Germany, Italy and Japan, although heavy Government expenditure upon rearmament and investment for self-sufficiency programmes has maintained business activity. In these countries, however, special factors affected share prices. In Italy, they were probably affected by the capital levy imposed on joint-stock companies;² in Japan, by the prohibition against raising the rate of dividends;³ and, in Germany, by increased taxation on companies' profits, by sales of Jewish property and by decreased profit margins.⁴

The prospect of lower profits normally reduces, not only share prices, but also capital issues for the development of business enterprises. The table on page 94 illustrates the connection between these factors. For example, a fall in profits between 1937 and 1938 in the United States was accompanied by a decline both in share prices and in capital issues. In the Netherlands, Sweden and the United Kingdom, however, share prices and capital issues declined between 1937 and 1938 in spite of a rise of profits. To some extent, political uncertainty has depressed share prices out of their normal relationship with profits; and, owing to a time-lag in the declaration of profits, the rise in the profit index may refer largely to a previous period of prosperity. Private capital issues, as shown by the table, rose between 1937 and 1938 only in Germany, where the bulk of such issues serves to finance the four-year plan or other Government schemes of capital development.

¹ Cf. Chapter II, pages 65 and 66.

² Cf. Chapter II, page 81.

³ Cf. Chapter I, page 41.

⁴ Cf. Chapter I, page 32.

*Profits, Share Prices and Capital Issues.*¹

(1929 = 100.)

	1936	1937	1938
<i>France:</i>			
Profits (joint-stock companies)	74	84	...
Industrial share prices	33	44	41
Gross capital issues by domestic companies	19	27	18
<i>Germany:</i>			
Profits (extractive and manufacturing joint-stock companies)	94	...	...
Industrial share prices	78	87	85
Net domestic issues other than by State and public bodies	25	30	40
<i>Japan:</i>			
Profits (industrial, commercial and financial companies)	157	192	...
Industrial share prices	134	148	133
Gross capital issues of companies	150	199	...
<i>Netherlands:</i>			
Dividends (all joint-stock companies)	45	69	76*
Industrial share prices	45	67	65
Net capital issues by domestic companies	3	22	11
<i>Sweden:</i>			
Profits (industrial companies)	91	112	127
Industrial share prices	90	104	99.5
Total share issues	53	65	46
<i>Switzerland:</i>			
Dividends (industrial joint-stock companies)	47	58	...
Industrial share prices	81	106	130
Net capital issues by domestic companies	7	19	16
<i>United Kingdom:</i>			
Profits (industrial companies)	96.5	113	121
Industrial share prices	116	108	88
Net capital issues by domestic companies	123	84	57
<i>United States of America:</i>			
Profits (industrial companies)	69	76	32.5
Industrial share prices	67	69	52
Net capital issues by domestic companies	15	15	11

* Provisional.

¹ For Indices of Profits and Share Prices, cf. League of Nations: *World Production and Prices, 1938/39*, pages 81 and 82. For figures of Capital Issues, cf. League of Nations: *Statistical Year-Book, 1938/39*, Table 134.

MONETARY POLICY IN CERTAIN INDUSTRIALISED COUNTRIES

The recession of business activity in the United States of America in 1937 and 1938 led to a marked change of monetary policy in that country. During 1936 and the first half of 1937, certain restrictive monetary measures had been taken to prevent the too rapid development of inflationary and speculative tendencies.¹ In the second half of 1937 and during 1938, this policy was reversed. In the summer and autumn of 1937, the Federal reserve banks reduced their discount rates, and increased the supply of credit by purchasing securities in the open market on a small scale; and \$300 million of gold was added to the banks' reserves by transference from the "inactive gold fund".

In April 1938, two further substantial measures of monetary expansion were undertaken. In the first place, the legal reserve requirements of the member banks were reduced by approximately 13%, and \$750 million of the cash balances of these banks was thus automatically transferred from the category of "required" to that of "excess" reserves. Secondly, the "inactive gold fund" was abolished; and the Treasury accordingly transferred some \$1,400 million of gold certificates to the Federal reserve banks, thereby increasing its cash balances with these banks by a corresponding amount. The subsequent expenditure of these balances increased the cash reserves of the member banks; and, at the same time, enabled the Government to finance its budgetary deficit without adding a corresponding sum to the public debt. The abolition of the "inactive gold fund" has also enabled a substantial part of subsequent imports of gold to be added to the reserves of the banking system.

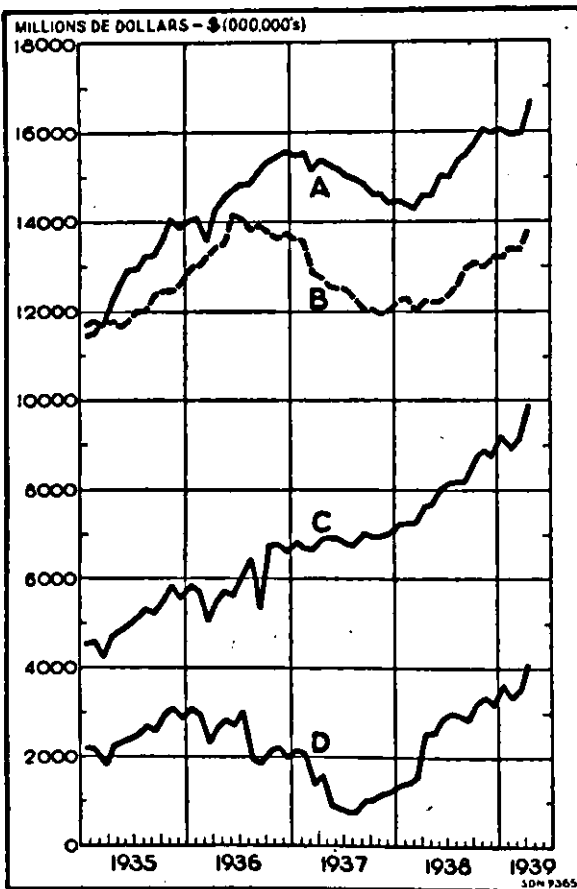
As the graph on page 96 shows, the total reserves of the member banks rose very considerably during 1938, after a period of comparative stability in 1937. The excess reserves of the member banks, which provide a more sensitive index of the liquidity of the banking system, fell from the beginning of 1936 until the autumn of 1937 as a result of the restrictive measures mentioned above; but they subsequently rose again to a record level by the end of 1938 as a result of the change in monetary policy. The graph also shows that this change in policy has had a similar effect upon the total supply of deposit money and upon the investments of the member banks. During 1937, the fall in excess reserves was accompanied by a reduction in the total of demand deposits of the reporting member banks and by a reduction in their investments. But, during 1938,

¹ Cf. *World Economic Survey, 1937/38*, pages 102 and 103.

these banks were enabled to increase their total investments again, and there was a simultaneous rise in their demand deposits. As the graph on page 90 shows, this expansive monetary policy has caused both long-term and short-term interest rates to fall to exceptionally low levels in the United States in spite of the requirements of the Government for the finance of the increased budget deficit.

Member Banks Reserves, Deposits and Investments.

- A: Demand deposits of reporting member banks.
- B: Total investments of reporting member banks.
- C: Total reserves of member banks.
- D: Excess reserves of member banks.



As the graph on page 90 shows, this expansive monetary policy has caused both long-term and short-term interest rates to fall to exceptionally low levels in the United States in spite of the requirements of the Government for the finance of the increased budget deficit.

In the United Kingdom, there was a moderate decline both in the supply of deposit money and in the amount of currency in the hands of the public in the course of 1938. While this factor may have slightly influenced the course of business activity, it cannot have initiated the recent recession. For the recession started in the middle of 1937, whereas both the currency in the hands of the public and the volume of

deposit money rose during 1937 to record levels in December of that year.

The following figures analyse these changes in monetary supplies in greater detail. The decline in the supply of deposit

Position of the London Clearing Banks.

	January 1937	January 1938	January 1939
	£ (000,000's)		
Deposits	2,307	2,329	2,230
Cash reserves	238	251	248
Call money and bills discounted	524	485	399
Investments	669	636	624
Advances	880	965	968
	%	%	%
Cash reserves as a percentage of deposits .	10.3	10.8	11.1
Cash, call money and bills discounted as a percentage of deposits	33.1	31.6	29.0

money during 1938 was, in the main, caused by the outflow of foreign funds from the United Kingdom. The funds which were being exported in this way were paid over to the Exchange Equalisation Fund in return for gold, and the Fund in turn used the deposit money thus acquired to cancel Treasury bills issued to the banks and the discount market. The London clearing banks regard that part of their liquid funds which they invest in bills or lend to the discount houses for investment in bills as constituting a second line of reserves against their deposits; and this reduction in the supply of Treasury bills removed a large part of these liquid assets from the banking system. The substantial fall in deposits cannot be explained as a result of the very slight reduction in the cash reserves of the clearing banks which occurred in 1938; for the cash reserve ratio of these banks rose from 10.8% to 11.1% during 1938. But, as can be seen from the table, the scarcity of bills caused the ratio of deposits covered by all liquid assets — including cash, money at call and bills discounted — to fall below the conventional minimum level of 30%.

In order to prevent a more serious decline in this ratio of liquid assets to deposit liabilities, the banks were obliged to reduce their investments in securities by some £12 million in the course of 1938. Such investments had declined still more seriously during 1937, largely as a result of the rapid rise which had occurred in the demand for advances by the banks' customers in that year. This continued sale of long-term securities by the banks, at a time when Government borrowing for rearmament was increasing, partly explains the rising trend of long-term interest rates which can be observed in the graph on page 90. On the other hand, the scarcity of Treasury bills caused short-term interests to remain at a very low level,

except for a short-lived rise in April 1939 resulting from a temporary reduction in the commercial banks' cash reserves.

It is not to be assumed that the whole of the decline in the supply of deposits during 1938 represented a reduction in the amount of active deposits available for circulation in the United Kingdom; for foreigners who exported their capital in the course of the year previously held some part of it in the form of idle deposits. But a large part of this outward transfer of foreign funds was effected through sales of foreign-owned securities in the London market; the active deposits obtained from the sale of these securities were paid to the Exchange Equalisation Fund for the purchase of gold for export; and the Fund in turn cancelled these deposits by using them for the redemption of Treasury bills held by the clearing banks.

As has been seen in the previous chapter, in 1939 it was decided greatly to increase the scale of Government borrowing for rearmament expenditure. In July 1939, it was officially announced that as much as £150 million of this borrowing might be financed by the issue of Treasury bills; and with this large increase in the supply of liquid assets, the clearing banks would be in a position to build up their investments in long-term securities again. In fact the tender issue of Treasury bills, which had fallen from £605 million in January 1938 to £355 million by March 1939, rose to £468 million by June 1939.

It has already been shown¹ that the supply of money increased in France during 1938, and that this was accompanied by a moderate rise in prices and by a marked reduction in interest rates. The reduction in interest rates was most marked after the autumn of 1938, and has continued during the first months of 1939, as may be seen from the graph on page 90. The improvement in monetary conditions was largely due to the repatriation of French capital, which started in May 1938 and, after a renewed outflow during the summer months of that year, continued steadily after November 1938.

In previous years, the creation of new monetary supplies through Government borrowing from the Bank of France had been largely offset by the export of capital. But between the end of April and the end of December 1938, more than 20,000 million francs of new money was made available in France. The greater part of this — between 13,000 and 14,000 million francs — was due to the repatriation of French capital; some 6,000 million francs was due to Government borrowing from the Bank of France; and, in addition, there were some

¹ Cf. Chapter I, page 28.

other minor sources of supply, such as the purchase in the open market of 1,900 million francs of short-term securities by the Bank of France, after authorisation to conduct such operations had been given to the Bank by decree in July 1938.

In Germany, the increase in the supplies of currency and deposits which has taken place at a rapid rate since 1935 continued during 1938 and the first months of 1939, in spite of the rapidly growing scarcity of unemployed resources. Thus, the amount of bank-notes and token coin in circulation rose by 2,909 million marks during 1938. Some part of this increase, officially estimated at 1,124 million marks, was due to the territorial expansion of the Reich which occurred during the year. But, even after deduction of this sum, the total currency in circulation increased by about 25%.

The changes in the supply of monetary funds are closely connected with the finance of extraordinary Government expenditure on rearmament and on investment under the four-year plan. Up to March 1938, a large part of such expenditure had been financed by the issue of "special" bills, which could be rediscounted with the Reichsbank and therefore formed a very liquid asset. In fact, as can be seen from the following table, the bill holdings of the German banks increased considerably from 1935 to March 1938; and, since it may be assumed

German Commercial Banks.

Reichsmarks (000,000's).

	November 1935	March 1938	October 1938	January 1939
Total bills held	6,011	8,189	8,917	9,914
Securities	2,774	3,313	3,572	3,606
Advances	4,588	4,568	4,774	4,817
Deposit liabilities	10,319	11,922	12,871	13,297

that the issue of genuine commercial bills did not rise appreciably during this period, it appears that a considerable volume of deposit money was created against the issue of bills for the finance of extraordinary Government expenditure. In March 1938, the issue of "special" bills was discontinued, and their place was taken by "delivery" bills, which were not rediscountable with the Reichsbank and which were to be issued only in such amounts as could be redeemed at maturity from the proceeds of current tax revenue or of long-term loans in the capital market.

It was thought, at the time, that this change would result in a reduction in the liquid assets of the banks, and would

thus bring the expansion of bank credit to a close. By October 1938, the currency of the "special" bills would normally have ceased, and the first batch of "delivery" bills issued in March 1938 were due for redemption; and it might have been expected that, at this point, the bill holdings of the commercial banks would at least cease to increase. In effect, as the table shows, the total bill holdings of the banks continued to increase rapidly. Partly as a result of the unexpectedly large Government expenditures which accompanied the political and military events of 1938, the "delivery" bills were issued in greater quantities than had been expected. Moreover, in October 1938, the "special" bills were only formally withdrawn; and they were largely replaced by two similar types of bill — the promissory notes issued by the Golddiskontbank and the so-called "block" bills issued by the Reichsbank. Meanwhile, the deposit liabilities of the commercial banks were further swollen by increased bank investments in securities and increased advances to customers. At the same time, there was a considerable increase in the total of new long-term consolidation loans issued by the Government. Such loans, which had amounted to 2,500 million Reichsmarks in 1936 and 3,500 millions in 1937, rose to some 8,000 million Reichsmarks in 1938.

The breakdown of the restrictive methods of finance planned in March 1938 was formally recognised a year later by the announcement of the new plan of finance through the issue of tax certificates, already outlined in Chapter I.¹ It has been estimated² that an annual issue of between 7,000 and 8,000 million Reichsmarks of these tax certificates is to be expected. The control of income payments to consumers and the rationing of factors of production to producers can prevent the inflationary effects upon prices and incomes which might be expected to result from so great an issue of liquid assets in conditions of full employment. It has, however, been announced that the capital market is to be opened to private business, and that the law limiting the payment of dividends is to be allowed to lapse.³ Such measures will relax existing restrictions upon expenditure of money for capital construction and for consumption, and will make even more necessary the quantitative control of the available supplies of goods and services.

In Japan also, monetary expansion continued during 1938, as the following figures show; and this continued expansion in conditions of practically full employment of the available

¹ Cf. page 37.

² Cf. Reichskreditgesellschaft Deutschlands Wirtschaftliche Lage in der Jahresmitte, 1939.

³ Cf. Ninth Annual Report of the Bank for International Settlements, page 111.

Japan: Increases in Monetary Supplies.

	Percentage increase in notecirculation	Percentage increase in commercial bank deposits
January 1937 to January 1938 . . .	+29%	+13%
January 1938 to January 1939 . . .	+13%	+22%

economic resources gave rise to problems of economic control similar to those already experienced in Germany.¹ The greater part of the expansion in the supply of money in Japan was due to the purchase of Government bonds by the banks against the creation of new currency and deposit money. As the following figures show, the financial requirements of the Government

Japanese Government Bonds.

	End of:			Net increase during 1938
	1936	1937	1938	
	Yen (000,000's).			
Bonds held by banks	6,999	8,032	11,295	3,263
Bonds held outside the banks . . .	2,073	2,553	3,640	1,087
Total of bonds outstanding . . .	9,072	10,585	14,935	4,350

for the prosecution of the war necessitated the issue of a large volume of Government bonds, three-quarters of which were purchased by the banking system.

MONETARY POLICY IN CERTAIN AGRICULTURAL COUNTRIES

The recession of trade activity in a number of industrialised countries in the second half of 1937 and during 1938 caused a sharp reduction in the receipts which most agricultural countries were able to obtain from their exports of primary products. As will be seen in Chapter VII, the majority of such countries reacted to this situation by further depreciation of their currencies or by increased control of their foreign exchanges; and, by these means, they avoided any severe internal monetary stringency. A certain number of agricultural countries, however, including the Argentine, Australia, New Zealand, India and Ecuador, lost gold and foreign exchange during this period; but, even in these countries, the normal consequences of internal monetary deflation were, in many cases, avoided.

The Argentine suffered a peculiarly sharp reversal of fortune with the onset of the economic recession; for the change was intensified by harvest fluctuations and by the substitution of

¹ Cf. Chapter I, pages 37-41.

an outflow for a previous inflow of capital. The earlier accumulation of reserves of gold and foreign exchange had been largely "sterilised" by the sale of Treasury bonds by the central bank and by the issue of Treasury bills to the market to purchase foreign exchange on Government account and so to prevent it from swelling the internal credit base. With the change in conditions, the loss of exchange reserves was offset by the reversal of these two policies; and, in consequence, there was only a moderate fall in deposit money and only a slight rise in interest rates.

In Australia, the exchange reserves of the Commonwealth Bank reached a high point in June 1937. The subsequent loss of reserves was offset to a large extent by a rise in the Bank's purchases of securities. There was, in consequence, no decline in the supply of deposit money, no rise in short-term interest rates, and only a moderate rise in long-term interest rates. The difficulties experienced in New Zealand were, however, more serious. The rise in the prices of New Zealand exports from 1935 to 1937 had not been accompanied by an accumulation of foreign exchange reserves. After the change in the trend of demand for agricultural products in the middle of 1937, the policy of increased Governmental expenditure¹ upon social services and public works maintained internal purchasing power. But, by maintaining the demand for imports, it increased the strain on the balance of payments, and this strain was further intensified during 1938 by an export of capital. Although the heavy loss of reserves of foreign exchange was offset to some extent by considerable advances of the Reserve Bank to the Government to finance part of its increased expenditure, there was some fall in the cash reserves of the trading banks and in their deposit liabilities. There was a significant rise in interest rates during 1938; and, in December 1938, exchange restrictions were imposed in view of the strain upon the balance of payments.

In India, the Reserve Bank's holding of foreign assets fell heavily between the middle of 1937 and the end of 1938. This was offset only to a small extent by the Bank's investments in domestic securities, with the result that the reserve balances of the commercial banks fell substantially. Although there was only a moderate fall in the deposit money supplied by these banks, the tighter monetary conditions caused a sharp rise in short-term interest rates. In Ecuador, a substantial part of the central bank's losses of gold and foreign exchange was offset by an increase in its loans and advances; and there was no serious reduction in the supply of deposits or of currency.

¹ Cf. Chapter II, pages 62 and 64.

Chapter IV.

PRODUCTION AND PRICES ¹

PRIMARY PRODUCTION

Between 1937 and 1938, as is clear from the graph on page 104, there was a slight decline in the level of world production of primary commodities. The chief cause of this decline was the fall in demand for raw materials which resulted from the recession in business activity in the United States of America. In Europe and Latin America, primary production actually rose slightly; but, in North America, it fell by almost 8%.

Primary products may be distinguished, according to their origin, as agricultural and non-agricultural; and, as a general rule, the output of agricultural products is less sensitive to variations in business activity than the output of non-agricultural. This is so for two reasons: in the first place, agricultural production cannot quickly or easily be adjusted to a change in demand; and, secondly, agricultural production is largely composed of foodstuffs, the demand for which is less variable than the demand for raw materials. In fact, between 1937 and 1938, world agricultural production fell less than 1%, while non-agricultural production of primary products fell by nearly 8%. There was a very marked decline of more than 17% in non-agricultural production of primary commodities in North America; and this illustrates the great influence which the American business recession exercised upon primary production through its effect in depressing the demand for raw materials.

It is also possible to distinguish primary products according to the uses to which they are put, as foodstuffs or as raw materials. The graph on page 104 brings out the fact that the production of foodstuffs is much less sensitive than that of raw materials to changes in business activity; for, whereas the world production of raw materials fell by as much as 9½%, that of foodstuffs rose slightly between 1937 and 1938. The production of raw materials in North America fell by more than 20%.

As a result of the decline in demand, stocks of primary products rose after the middle of 1937; and this increase of

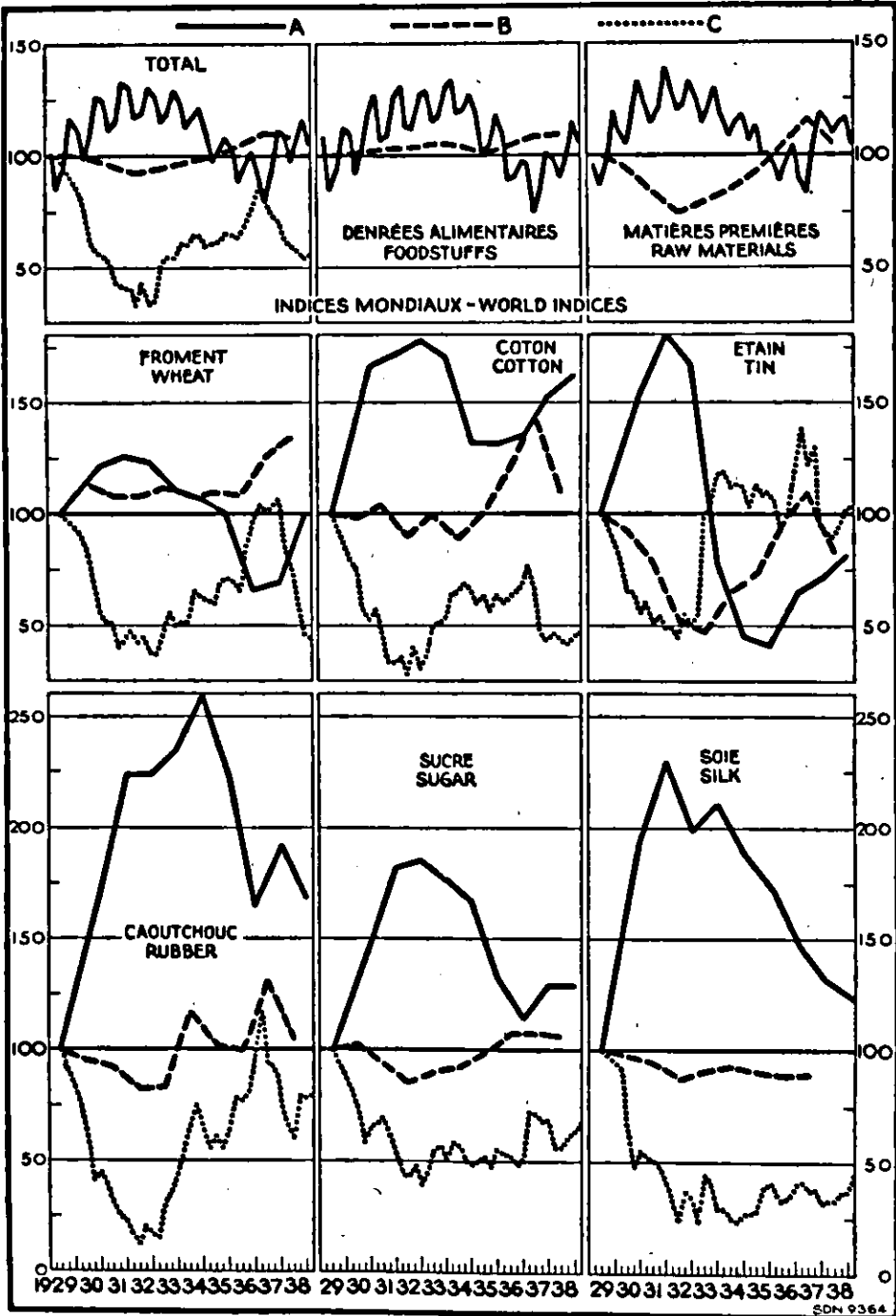
¹ Cf. League of Nations, *World Production and Prices, 1938/39*.

Production, Prices and Stocks of Primary Products.
(1929 = 100.)

A Stocks.

B Production.

C Prices.^a



^a Prices in dollars, from the *Survey of Current Business*.

stocks occurred in the case of foodstuffs as well as of raw materials. But stocks of raw materials, if seasonal movements are neglected, declined again somewhat towards the end of 1938; for such stocks were lower at the end of 1938 and the beginning of 1939 than at the corresponding dates of the previous year. This decline may be attributed to Government demands for rearmament purposes and for the formation of undisclosed war reserves as well as to the general economic recovery which developed in a number of countries.

As the graph shows, the prices of primary products are closely associated with the movements of stocks. With the decline in stocks, the prices of primary products rose from the end of 1932 to the beginning of 1937; and there followed a sharp decline in prices with the growth of stocks until the end of 1938, when the price index was lower than it had been at any time since the middle of 1933. Prices, however, showed some small recovery in the first quarter of 1939, when the fall in raw-material stocks had improved the market position.

The graph on page 104 also illustrates the position of a number of individual products. In the case of two of these products, wheat and cotton, for which there are no international schemes restricting production or export, bumper crops have led to sharp rises in stocks and sharp declines in price. There were bumper wheat crops in both 1937 and 1938, and, in consequence, the price had fallen by the end of 1938 to a level not far above the lowest point reached in 1933. A serious discrepancy has, indeed, arisen between the requirements of the countries normally importing wheat and the exportable supplies of the other countries, as the following figures show:

	World import requirements of wheat	World exportable supplies of wheat
	Metric tons (000,000's)	
1936	16	19
1937	14	19
1938*	16	32
	Bushels (000,000's)	
1936	599	713
1937	522	698
1938*	573	1,180

* Forecast.

The world production of cotton was very high in 1937, and, in spite of a considerable decline, still remained high in 1938. This, combined with a 14% decline in the consumption of cotton

in 1938 as a result of the business recession, caused stocks of cotton to rise rapidly and prices have declined sharply since the first half of 1937.

In the case of all the commodities shown on the graph on page 104, prices appear to be closely associated with changes in stocks and usually decline when stocks increase. Between the end of 1936 and the end of 1938, stocks rose in the case of each commodity shown, except silk, and, in each case, prices have declined. The increase in the stocks of tin, rubber and sugar has, however, been checked by the operation of international schemes restricting production or export;¹ and the operation of these schemes had thus helped to put a brake on the decline in their prices.

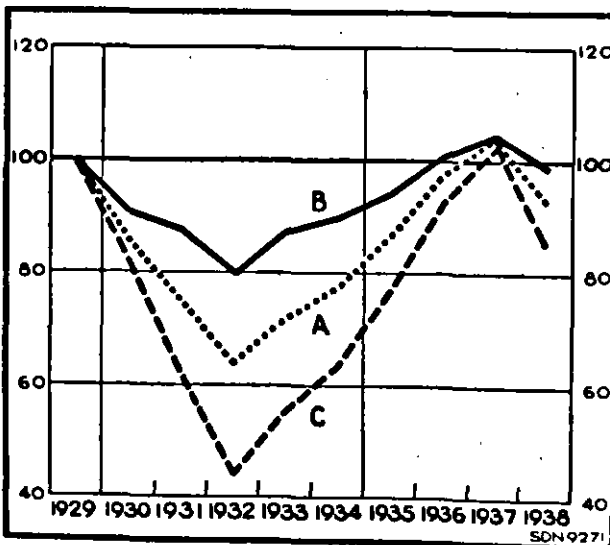
INDUSTRIAL PRODUCTION

The annual figures of world industrial production fell by approximately 10% between 1937 and 1938, after having risen continuously since 1932, which marked the bottom of the post-1929 slump.

World Manufacture of Capital Goods and Consumption Goods.

(1929 = 100.)

- A All goods.
- B Consumption goods.
- C Capital goods.



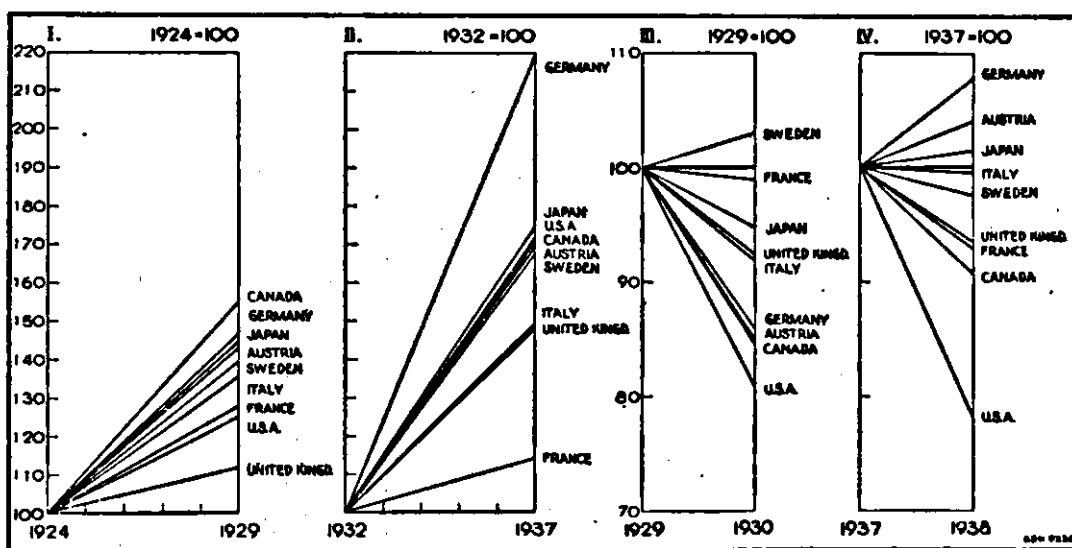
This decline was the result of the recession of business activity in the United States and in other important industrialised countries, which started in the middle of 1937. Normally, in a period of trade recession, the production of goods for current consumption falls much less rapidly than that of goods used for the expansion of capital equipment. For, on the one hand, capital development is normally postponed when the profitability of industry is diminished; and, on the

¹ For the recent developments of such schemes, see Chapter VIII, pages 197 and 198.

other hand, when incomes decline, savings can be more easily reduced than expenditure which is necessary to maintain existing standards of consumption. As can be seen from the graph on the preceding page, the production of capital goods, which had fallen more rapidly between 1929 and 1932 and had risen more rapidly between 1932 and 1937, again fell more rapidly than the production of consumption goods between 1937 and 1938.

These annual averages of world industrial production are to some extent misleading. For, in recent years, very divergent movements have occurred in the industrial production of different countries, so that it is no longer possible to indicate the trend of events by a single world index. Moreover, in the course of 1938, there was, in many countries, a sharp change of trend, which is concealed by the annual figures.

Changes in Industrial Production in 1924-1929, 1932-1937, 1929-1930 and 1937-1938 in Various Countries.¹

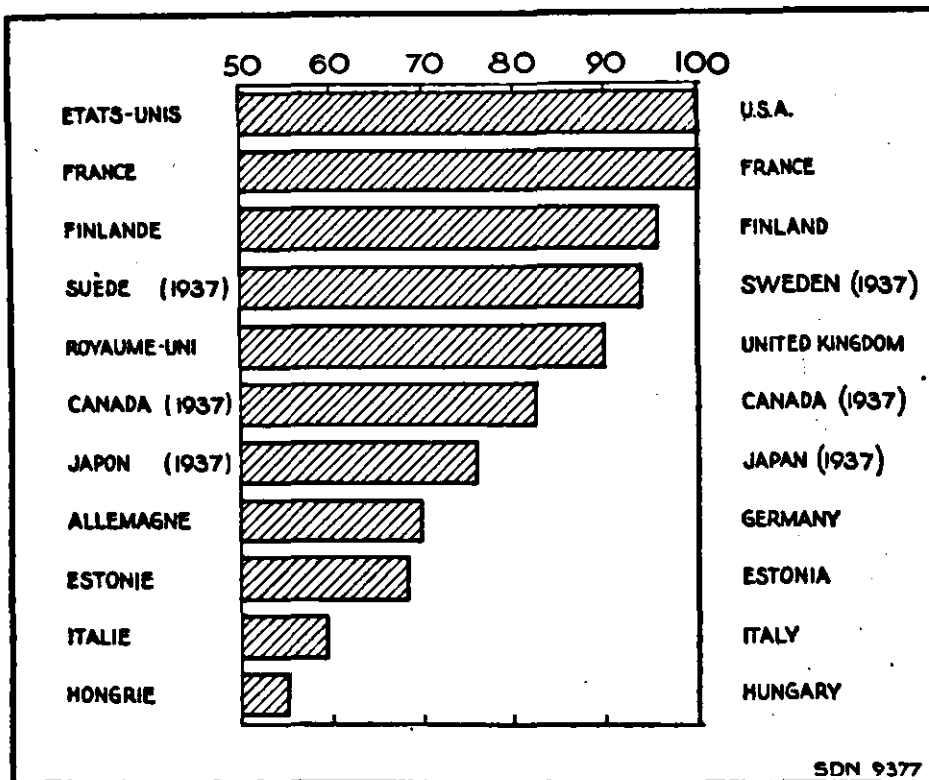


The disintegration of the world economy is illustrated by the graph on this page. If the upward movement of industrial production which occurred during the five years from 1924 to 1929 is compared with the upward movement in the five years from 1932 to 1937, the increased divergences between the different countries is clear. In the earlier period, the increases in industrial production in the different countries shown on the graph ranged between 12% and 55%, whereas, in the latter

¹ Cf. League of Nations, *World Production and Prices, 1938/39*, page 9.

period, the increases ranged from 14% to 120%. A similar distinction is to be observed between earlier and later years of decline of industrial production. The limits of the changes which occurred in the industrial production of the individual countries from 1929 to 1930 lay between a rise of 3% and a fall of 19%, whereas from 1937 to 1938 the corresponding limits were between a rise of 8% and a fall of 22%.

Ratio between the Quantum of Imports and Industrial Production in Various Countries in 1938.¹
(1929 = 100.)

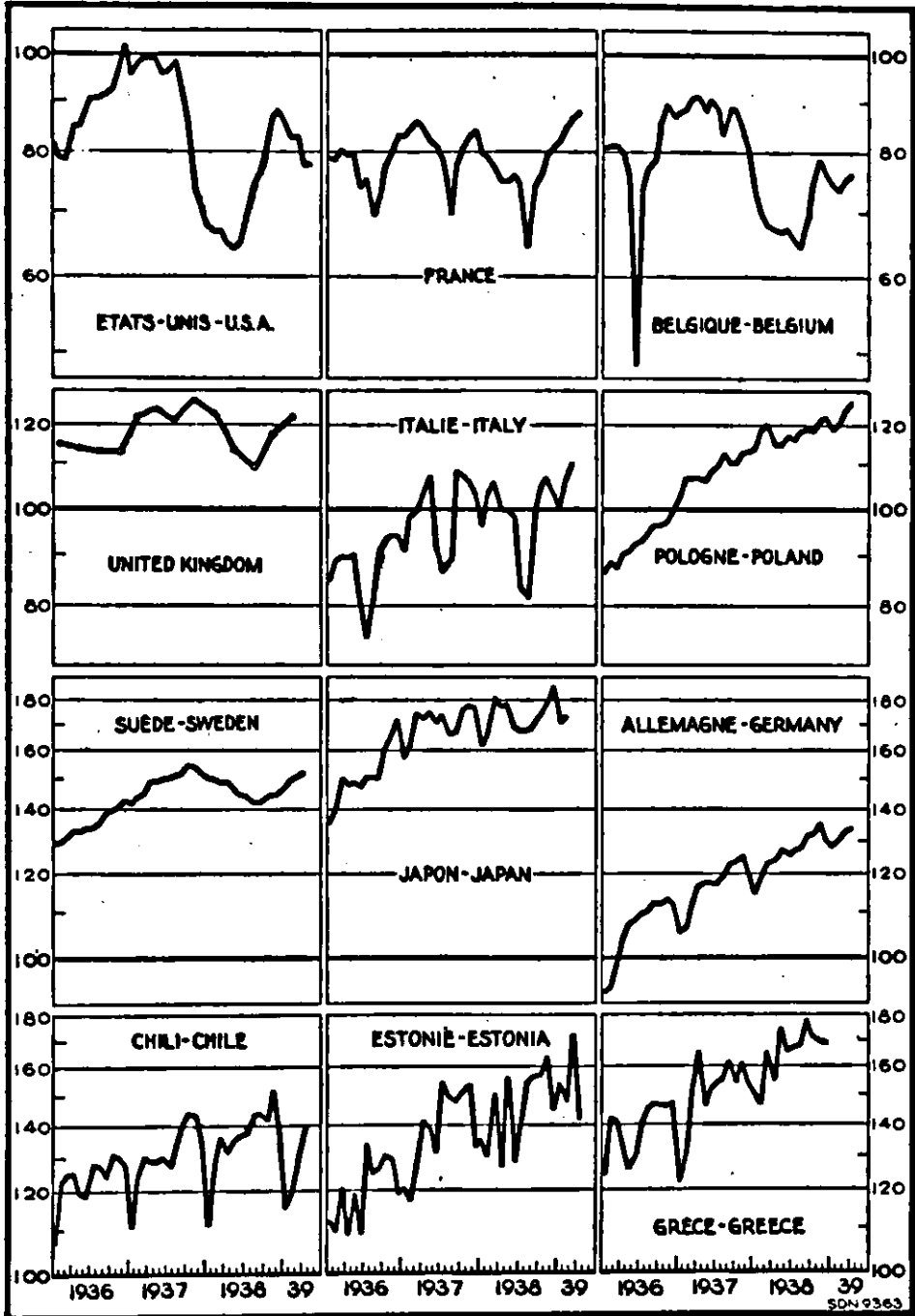


Various factors have contributed to make the world economy a less well integrated unity. The abandonment of the international gold standard, the growth of tariffs and import quotas, the imposition of restrictions on foreign lending and on foreign exchange dealings generally, and various measures taken to increase the potential self-sufficiency of different countries have made the individual national economies less directly dependent upon each other. At the same time, various divergent internal economic measures of monetary policy, of industrialisation,

¹ Cf. League of Nations, *World Production and Prices, 1938/39*, page 10.

Industrial Production in Various Countries.

(1929 = 100.)



of State expenditure upon capital works and rearmament, and generally increasing State intervention in economic affairs have caused internal economic trends to diverge sharply in different countries. One of the most marked results of this tendency is the decreasing importance of foreign trade in relation to home production, and as the graph on page 108 shows, since 1929, home production has increased relatively to importation in most countries. In Germany, the ratio of imports to home production has fallen by 30%, and, in Italy, by as much as 40% since 1929.¹

Not only are the national divergences of the movements of industrial production greater than before; but also, in recent months, the changes in the trend of production have been more rapid and more frequent than previously. The graph on page 8 of Chapter I has shown the marked changes that occurred in the world index of industrial production in 1937 and 1938. In the middle of 1937, an upward movement of production gave place to a sharp recession. But, in the middle of 1938, production started once more to increase, largely as a result of measures of monetary and economic expansion which were undertaken in the United States of America and in other countries, and of increased expenditure on armaments.

Recent developments in the different countries are illustrated by the graph on page 109.

The heavy fall in industrial production in the United States between the middle of 1937 and the middle of 1938 and the subsequent recovery until the end of 1938 is very marked; but, as the graph shows, this recovery was followed by a more moderate decline of production in the first months of 1939. While the Government action taken in 1938 to counteract the depression seems to have averted the possible threat of a major recession, there has been no continued movement towards full recovery. As the following figures show, the production of consumption goods by the end of 1938 had recovered to a level

United States: Industrial Production.

(1929 = 100.)

	Capital goods	Consumption goods
May 1937	99	100
May 1938	42	80
December 1938	75	97
May 1939	59	92

¹ The disintegration of the world economy has also caused the foreign trade of the different countries to be concentrated more exclusively within certain "economic blocs". Cf. Chapter VIII, page 186.

almost as high as in May 1937, and even in May 1939, after the renewed recession, was only some 8% below the level of May 1937. But, on the other hand, the production of capital goods, which — as normally happens in a recession — fell very severely between May 1937 and May 1938, at the end of 1938 was still as much as 25% below the level of May 1937 and fell still farther in the first months of 1939. Government expenditure on relief appears to have prevented a cumulative decline in consumption; but full recovery seems to wait upon a substantial increase in investment in real capital development.

France and Belgium, as well as the United States, are among the countries in which industrial production in 1937 had failed to reach the 1929 level; and in both of these countries, there was a considerable decline in output between 1937 and 1938. In Belgium, fluctuations in production closely followed similar fluctuations in the United States, and a recovery in the second half of 1938 was followed by a moderate recession in the first half of 1939. But in France, largely as a result of the economic and financial reforms of November 1938 to which reference has been made in Chapter I, production made a real recovery in the first months of 1939. In addition to these general economic and financial reforms, increased expenditure upon armaments has been a direct cause of a considerable part of the increased industrial activity.

In the United Kingdom and the Scandinavian countries, which are represented by Sweden in the graph on page 109, industrial production by 1937 had risen some 20% to 50% above the 1929 level. These countries were also affected, though to a smaller extent, by the industrial recession between the middle of 1937 and the middle of 1938; but, as the graph shows, they have made a substantial recovery since the end of 1938. In the United Kingdom, this recovery of production has been very greatly influenced by the increased demand for armaments; and the demand for Swedish products has also been stimulated by rearmament both at home and abroad.

Industrial production has developed differently in the more rigidly controlled economies. Thus, in Germany, where internal activity for rearmament and self-sufficiency has been maintained through a system of strict Government regulation, industrial production, apart from seasonal variations, continued to expand during 1937 and 1938. The same was true also of Japan, although, as the graph on page 109 shows, the rate of expansion fell off in 1937 and 1938; and, as has been shown in Chapter I (page 39), the production of consumption goods declined, while the production of "investment" goods was greatly stimulated by armaments demand. In Italy, on the other hand, there was a

considerable decline of production between the middle of 1937 and the middle of 1938; but the decline was more than balanced by the recovery in the last months of 1938 and the first months of 1939.

In Poland, as can be seen from the graph, industrial production expanded without serious interruption during 1937, 1938 and the first half of 1939; and this activity can be ascribed in large measure to the schemes of Government investment and development to which reference has been made in Chapter II (pages 65 and 66). The Union of Soviet Socialist Republics is the most striking example of a controlled and planned economy, in which heavy State expenditure on capital development has maintained a rapid and uninterrupted expansion of industrial activity. In 1937, the second five-year plan was completed, during the course of which the production of capital goods had increased by 140% and that of consumption goods by 100%. The third five-year plan was introduced in the course of 1938, and it foresees an increase of 100% in the production of capital goods and of 70% in that of consumption goods before the end of 1942.

The last three countries shown in the graph on page 109 — namely, Chile, Estonia and Greece — are all countries which are young industrially; and, for this reason, recent industrial expansion had raised the level of production in 1937 considerably above the 1929 level. On the whole, the industrial production of these countries continued to expand between 1937 and 1938.

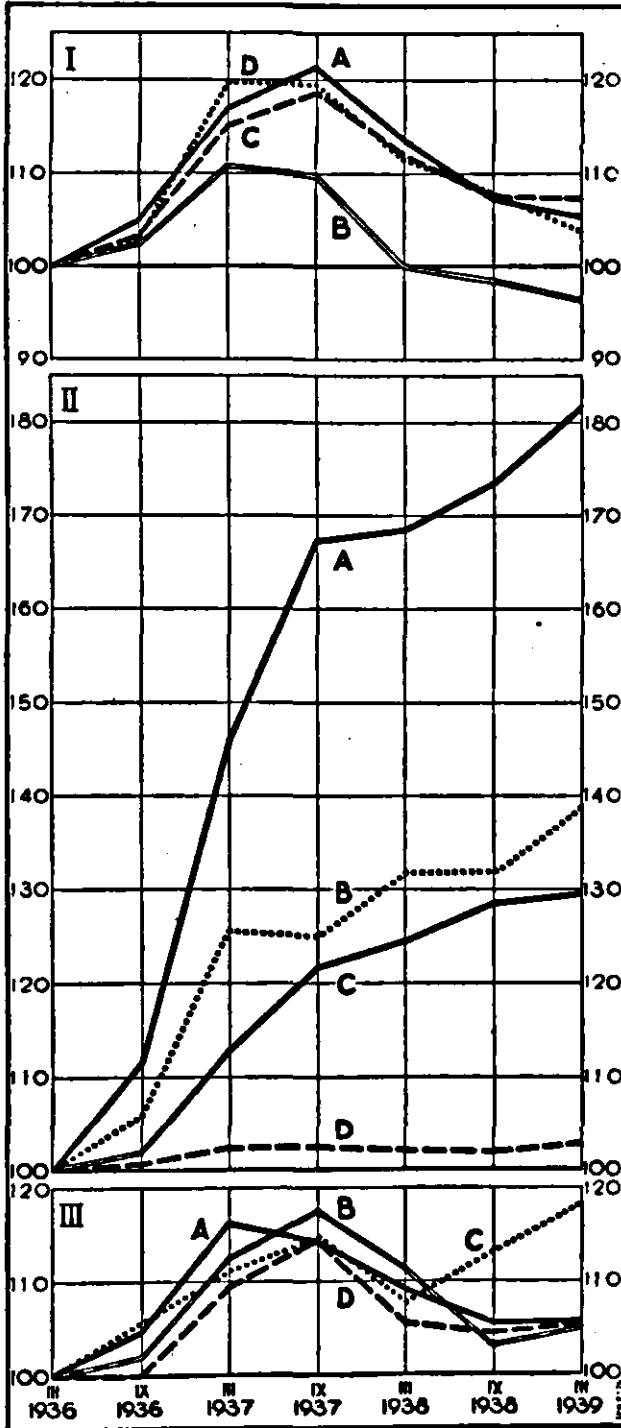
PRICES

In an earlier section of this chapter (pages 105 and 106), reference has been made to recent fluctuations in the prices of primary products. As has been seen, some prices fell very sharply after the break in the boom of commodity prices, which occurred in the first months of 1937; and, although, for a number of individual commodities, there has been a moderate rise of prices since the last months of 1938, on the whole, this rise has been slight, in spite of the considerable measure of economic recovery which has been achieved since the middle of 1938.

In fact, this absence of any general rise in prices, such as is usually associated with a rising demand for goods and services, is a marked feature of the rise in industrial activity which has occurred in many countries since the middle of 1938. Recent price movements are illustrated for a number of individual countries in the graph on page 113. In all the countries shown on the graph, wholesale prices rose between March 1936 and March 1937, which marked the peak of the speculative boom

Wholesale Prices in Various Countries.

(March 1936 = 100.)



A United Kingdom.
 B United States.
 C Sweden.
 D Belgium.

A France.
 B Japan.
 C Italy.
 D Germany.

A Poland.
 B Argentine.
 C Australia.
 D India.

in commodity prices. For the majority of countries, prices either fell moderately or at least slackened their rate of rise between March and September 1937. Since September 1937, wholesale prices have fallen in the majority of countries; and, as the graph shows, this decline of prices continued between September 1938 and March 1939 in such countries as the United Kingdom, the United States, Sweden and Belgium in spite of the industrial recovery which those countries experienced in the last half of 1938 or in the first months of 1939.

As the graph shows, movements of wholesale prices have followed a similar course in agricultural countries, such as Poland, Argentine, Australia and India, except that a small recovery of prices has occurred since September 1938. The rapid rise in wholesale prices in Australia between March 1938 and March 1939 appears to be a marked exception to the general movement. Prices in certain important industrialised countries, such as France, Japan, Italy and Germany, have also moved in an exceptional way for various reasons. The graph shows the very rapid rise in French prices which accompanied the depreciation of the franc, the rise in wage rates and the various social measures adopted in the last half of 1936 and during 1937. As a result of the measures to which reference has been made in Chapter I (pages 26-31), this price rise was modified in the course of 1938; but, nevertheless, the price rise has continued, although at a much reduced rate. In Japan and Italy, heavy expenditure for military operations or for military preparations, financed by budget deficits, in spite of comparatively full employment of the available economic resources, has led to a continued rise in prices. In Japan, the measures of price control, to which reference has been made in Chapter I (page 40), have done no more than mitigate the rising trend of prices. On the other hand, in Germany, price control has maintained wholesale prices at a practically constant level since 1936, in spite of the considerable price changes which have occurred in the majority of other countries.

Fluctuations in prices are of the greatest importance when they involve changes in price relationships. If all prices, including such prices as the wage rate of labour, were to fluctuate at the same rate in the same direction, most economic relationships would remain substantially unaltered. But a rise in the price of the goods and services which a group of persons buy in relation to the prices of the goods and services which they sell has far-reaching effects upon business activity and upon economic welfare.

One of the most important economic relationships of this kind is the ratio between the prices of agricultural products and

of manufactured commodities. In a period of falling demand, the prices of agricultural products normally decline much more rapidly than those of manufactured goods, whose output is usually more promptly reduced to meet the decline in purchases. Between the middle of 1937 and the middle of 1938, as the recent trade recession developed, the prices of agricultural products fell in relation to those of manufactured goods. These movements are illustrated by the graph on page 170 of Chapter VII, which shows the relationship between the prices at which manufactured goods and primary products have been exchanged in international trade. From the middle of 1937 to the middle of 1938, the prices of imports of raw materials and foodstuffs fell in relation to the prices of the manufactured exports of industrialised countries such as the United Kingdom and Germany; but there was some moderate reversal of this movement towards the end of 1938, as a result of the general recovery in business activity.

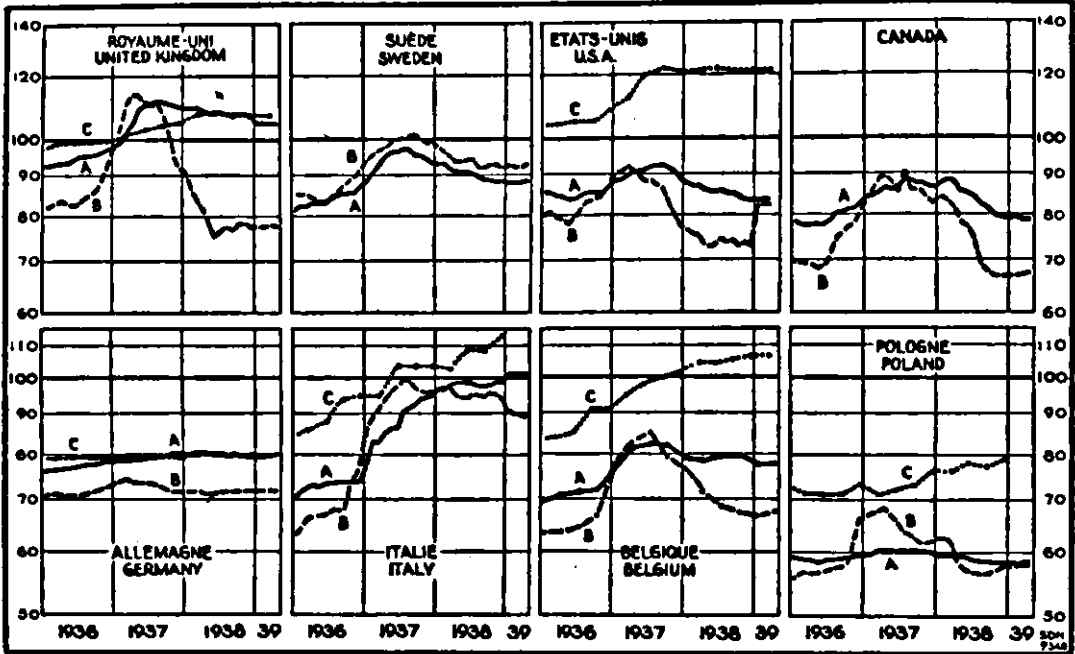
The graphs on page 116 illustrate the relationship between the prices of finished products and the prices of raw materials and of labour, which represent the most important costs of production. In practically all the countries shown in the graphs on page 116, the price of raw materials rose rapidly during the last months of 1936 and the first months of 1937, and then fell as business activity declined. In many countries, including the United Kingdom, the United States, Canada and Belgium, the prices of finished goods also at first rose and subsequently fell during the same periods; but they varied to a less marked extent. On the other hand, wage rates which rose in a number of countries during the period of rising commodity prices, did not show any tendency to decline in the subsequent period of falling prices. In Germany, however, during this period, the fluctuations in the prices of finished goods, of raw materials and of labour were very slight, as a result of the policy of wage and price control.

The second graph on page 116 shows the changes in the relationship between raw material and labour costs on the one hand and the price of finished products on the other hand. In a large number of countries, including the United Kingdom, the United States, Canada and Belgium, raw-material prices rose sharply in relation to the prices of finished commodities during the expansion of industrial production up to the middle of 1937, and then fell during the subsequent decline in industrial activity. Fluctuations in the general level of demand, as is usually the case, caused the costs of raw materials to vary more than the prices received for the finished products; and this in turn helped to mitigate both the upward and the downward movement of

Selling Prices and Industrial Costs.

(1929 = 100.)

A Prices of finished goods. B Prices of raw materials. C Wage rates.

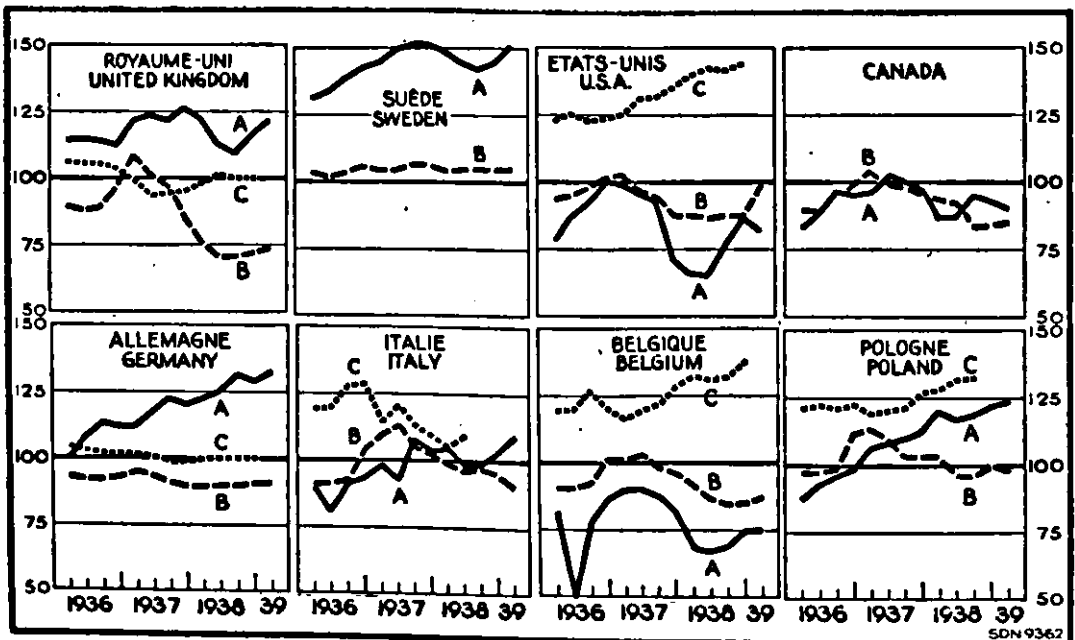


• United Kingdom: 1930 = 100.

Industrial Production and the Relation between Selling Prices and Costs.

(1929 = 100.)

A Industrial production.
 B Raw material prices as a percentage of prices of finished goods.
 C Wage rates as a percentage of prices of finished goods.



• United Kingdom: 1930 = 100.

industrial production. On the other hand, in certain countries, such as the United Kingdom and Belgium, wage costs appear to have fallen relatively to the price of finished products during the upward movement of industrial production and to have risen during the subsequent decline in industrial activity, as a result of the fact that wage rates are less sensitive than commodity prices to changes in the general level of demand. The rise in the relation of wage costs to selling-prices has been one of the factors restricting the volume of industrial activity during the recent recession; and, as the second graph on page 116 shows, this rise was particularly marked in the United States since the first quarter of 1937.

Chapter V

EMPLOYMENT, WAGES AND THE STANDARD OF LIVING

CHANGES IN THE DEMAND FOR LABOUR

In previous chapters, it has been shown that the demand for goods and services rose rapidly between 1932 and 1937 as the great majority of countries recovered from the severe post-1929 depression; that this recovery of demand gave place to a renewed recession between the middle of 1937 and of 1938; that certain countries, such as Germany and Japan, whose economies were dominated by the activity of war or of rapid rearmament, were not affected by this temporary decline; and finally that, in the majority of the other countries, there was a renewed recovery of demand in the second half of 1938. All these phenomena were accompanied by similar fluctuations in the demand for labour.

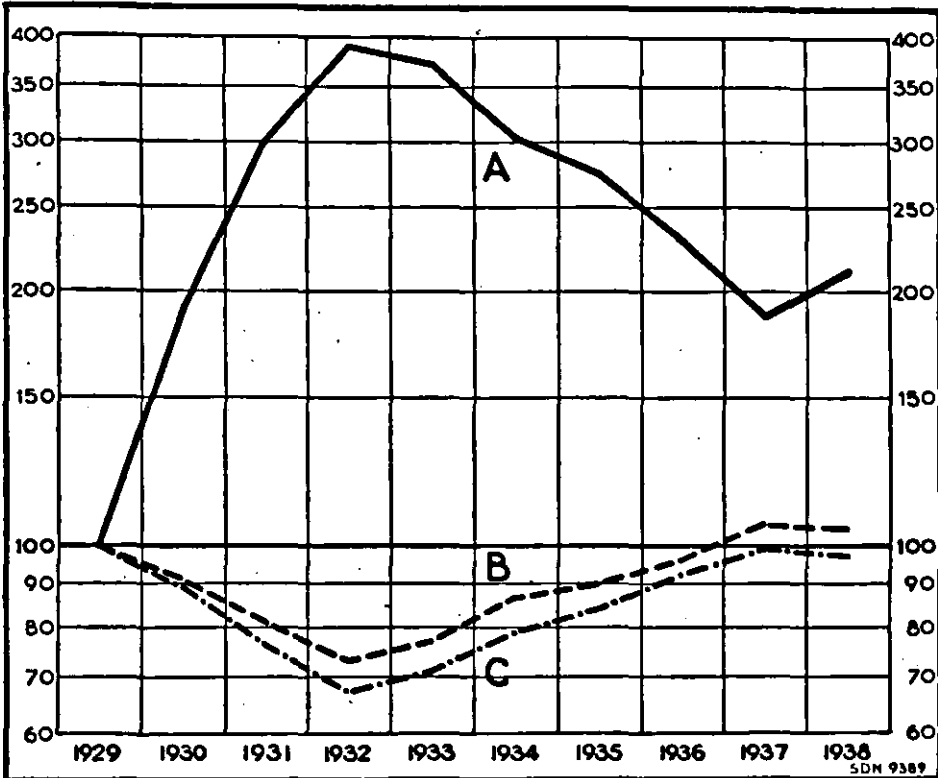
As the graph on page 119 shows, the total number of workers in industrial employment fell between 1929 and 1932 and then rose again until 1937. As a result of the fall in the demand for labour between 1929 and 1932, short-time was worked in many industries; and, in consequence, the total number of hours worked fell more rapidly than the number of workers in employment. With the recovery in the demand for labour between 1932 and 1937, short-time working has been reduced again; but as a result of organised efforts in many countries to restrict hours of work, the average hours of work have remained well below the 1929 level.

In 1929, the percentage of workers unemployed was comparatively low; but, as the graph shows, it increased about four-fold between 1929 and 1932. With the recovery in the demand for labour between 1932 and 1937, the unemployment percentage fell again, but it remained almost twice as high as in 1929. By 1937, the number of workers in industrial employment had risen again to the 1929 level; but the greater part of the natural increase in the number of workers between 1929 and 1937 had been added to the number of the unemployed. Some important industrial countries, such as the United States of America and France, have not fully recovered from the depression; and in others, such as the United Kingdom, the great

World Employment and Unemployment.

(Base: 1929 = 100.)

A Degree of unemployment. B Workers in employment in industry.
C Aggregate hours worked in industry.

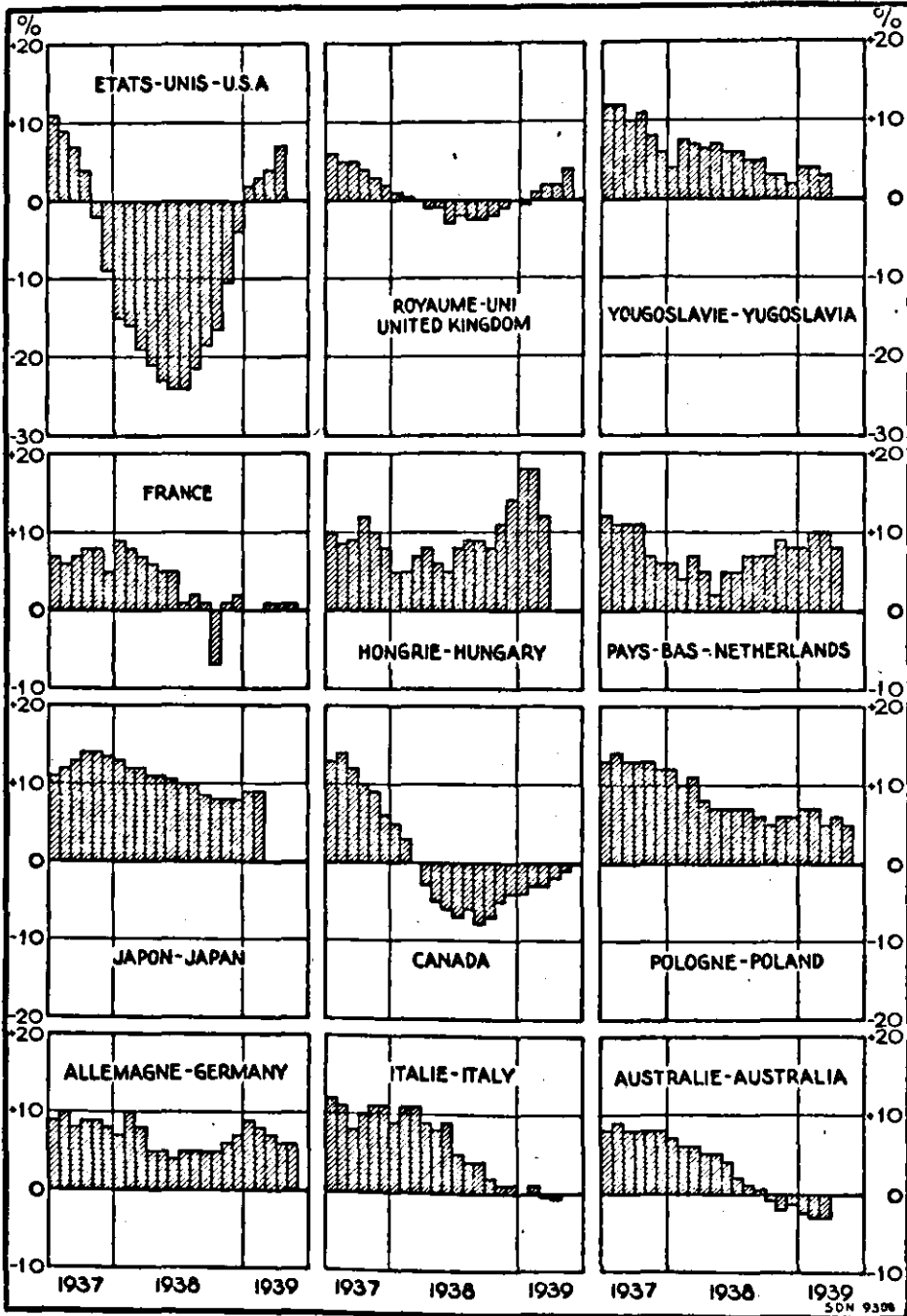


depression had intensified many structural changes in industry which left behind them large blocks of unemployment attached to special industries in certain depressed areas.

Between 1937 and 1938, there was a moderate rise in the degree of unemployment, as a result of the recession in trade activity, and the number of workers in industrial employment also declined slightly. But there was again a fall in the number of hours worked per worker in industry. In certain countries and in certain industries which were particularly affected by rearmament activity, hours of work were increased; but this influence was, for the world as a whole, overshadowed by the reappearance of short-time as a result of the recession and by the systematic organisation of shorter hours of work, which was continued in a number of countries.

These annual figures hide great divergencies in the developments as between different countries, and do not adequately

Percentage Changes in Industrial Employment since the Corresponding Month of the Previous Year.*



* United Kingdom: Employment in mines, industry, transport and commerce.

show the changes which occurred in the course of the years 1937 and 1938. The above graph which shows for a number

of countries the percentage change in the volume of employment between one month and the corresponding month of the previous year, reveals these recent developments more clearly.

In many countries, including Italy, Germany and Japan, employment continued to increase throughout 1937 and 1938. In these countries, the rate of increase of employment fell in the course of 1938; but this phenomenon — at least in the case of Germany and Japan — may be ascribed rather to the growing scarcity of labour than to the effects of the world recession. In a number of countries, however, the recession from mid-1937 to mid-1938 is clearly marked. This is particularly true of the United States, where employment in the middle of 1937 was some 10% higher than in the middle of 1936, but, in the middle of 1938, was nearly 25% lower than it had been a year previously. By the beginning of 1939, however, employment had recovered to its level at the beginning of 1938.

Other countries in which an increase of employment in the middle of 1937 gave place to a decline of employment by the middle of 1938 include Canada and the United Kingdom. But, largely as a result of the accelerated rearmament programme, there was subsequently a sharp rise of employment in the United Kingdom; and the number of workers in employment reached record levels in May and June 1939. The employment figures of certain other countries, such as France¹ and the Netherlands, also show the effects of the recession and subsequent recovery during 1937 and 1938. In these countries, the percentage increases in employment diminished between the middle of 1937 and the middle of 1938, and subsequently started to rise again.

WAGES AND EMPLOYMENT

The slackening in the demand for labour in many countries between the middle of 1937 and the middle of 1938, and the subsequent recovery of this demand, has had very little influence upon the rates of money wages. In a great many countries, wage rates are fixed by law, by collective agreements, or by decisions of courts of arbitration and of wage boards; and even where no such machinery for wage-fixing exists, wage rates are often conventionally inflexible.

As the following figures show, there was no tendency for the hourly money wages to fall during the decline in the demand

¹ The increases in the numbers employed in France during 1937 must be largely explained by the introduction of the forty-hour week. The total number of hours worked declined between 1936 and 1938, although the number of workers in employment rose during these years.

National Indices of General Level of Hourly Wages.
(Base: 1929 = 100.)

	Hourly money wages			Hourly real wages		
	June 1937	June 1938	December 1938	June 1937	June 1938	December 1938
Australia	87	94	103	103	108	117
Belgium	98	104	106	109	111	112
Denmark	105	112	114	101	105	108
France ^a	172	193	195	158	155	150
Germany	79	80	80	97	97	98
Italy	104	108	113	113	110	115
Japan ^b	93	101	111	93 ^c	95 ^c	102 ^c
Netherlands	81	85	86	101	102	104
Poland	72	78	79	118	129	131
United Kingdom ^d	103	108	107	111	113	113
United States	120	122	121	135	141	141
Yugoslavia ^b	86	90	91	111	102	102

Source: I.L.O. *Year-book of Labour Statistics, 1939.*

^a Metallurgy in the Parisian region only.

^b Daily earnings.

^c 1932 = 100.

^d Weekly rates.

for labour between the middle of 1937 and the middle of 1938. In fact, in every country shown in the table, there was some rise in the money wage rate between these dates, although in many cases the rise was very slight. In a number of cases, the rising tendency of money wage rates during this period may be regarded as a result of the time-lag which normally exists between a change in the demand for labour and the consequent adjustment of the rate of money wages. Thus the slight rise in hourly money wages in the United Kingdom and the United States between June 1937 and June 1938 may be interpreted as the postponed effect of an earlier period of expanding demand for labour; and, in both these countries, there was subsequently a slight fall in the money wage rate between June and December 1938.

In a number of cases, special factors have influenced the movement of hourly wages. In Australia, the rise was caused in large measure by the action of the Federal Arbitration Court in the second half of 1937 in making an addition to its basic wage, which affects many wage-earners directly or indirectly. Under the Australian system of wage regulation, the money wage rate is periodically adjusted in such a way

as to offset variations in the cost of living, so that the real wage rate is effectively raised when the basic wage is increased. In France, the available figures of hourly wages¹ show a rapid rise between June 1937 and June 1938 which represents the last stages in the rapid upward adjustment of hourly wages to offset both the reduction of earnings that would otherwise have resulted from the introduction of the forty-hour week and also the rise in the cost of living which followed upon the rise in wage costs and the depreciation of the franc. As has already been shown in Chapter I, this development came to an end in the course of 1938; and, in the second half of the year, the rise in wage rates was very moderate. Meanwhile, the cost of living had been rising somewhat more quickly than the rate of money wages, and, in consequence, there was a decline in real wage rates between the middle of 1937 and the end of 1938. In March 1938, the law regulating the fixation of minimum wage rates was considerably modified. By an Act passed in that month, wage rates fixed by collective agreement could be revised whenever the cost of living showed a rise of more than 5%. But such revisions could not take place more often than once in every six months, unless the cost of living had risen by as much as 10%; and, in addition, no rise in minimum wage rates could be allowed which was incompatible with the capacities of the particular branch of industry which was affected. This law helped to break the vicious circle of rising wage costs leading to rising prices and so, through a rising cost of living, to still further increases in wage rates.

In Germany, the policy of stabilising money wage rates and money prices was continued during this period, with the consequence — as can be seen from the table on page 122 — that wage rates remained practically constant both in money and in real terms. The growing scarcity of labour has led to a tendency for employers to offer higher wage rates in spite of these measures of wage control; and it is reported² that this tendency was accentuated in the course of 1938. For this reason, the control of wage rates was intensified; and the Labour Trustees were empowered to supervise all changes in wage-earnings and in conditions of work to prevent concealed wage increases. In both Italy and Japan, the very high level of Government expenditure on armaments has caused a rise in prices and in hourly money wages. In Japan, measures have been taken to control the tendency for rising prices.³ In Italy,

¹ Wages in metallurgy in the Parisian region.

² Cf. Reichskreditgesellschaft: *Germany's Economic Position at the Turn of 1938/39*.

³ Cf. Chapter I, page 40.

the rise in prices was more rapid than the rise in hourly money wages with the result that hourly real wages fell between June 1937 and June 1938; but this was more than counterbalanced by a general increase in hourly money wages which took place during the second half of 1938.

In a number of countries, measures have been taken in recent months to extend the system of wage control and the fixation of minimum wage rates. The most important of these measures was the enactment of the Fair Labour Standards Act in the course of 1938 in the United States, which, in the case of all workers engaged in inter-State commerce or in production of goods for inter-State commerce, fixes a minimum wage rate rising by stages from 25 cents an hour in 1939 to 40 cents an hour in 1945. Other countries in which arrangements for the fixation of minimum wages have been extended include the Argentine, Brazil, Canada, Colombia, Ecuador, Hungary, Ireland and the United Kingdom.¹

The relation between hourly real wages and the demand for labour is illustrated in the graphs on pages 125 and 126. In a period of declining business activity, when the demand for goods and services is reduced, money prices usually decline more rapidly than hourly money wages; and, in consequence, a decline in the demand for labour is often associated with a rise in hourly real wages. Indeed, the fact that the selling prices of the products of labour fall relatively to the money wage costs of production itself partly explains why the demand for labour is reduced in such a period. In a period of expanding demand, the opposite movements frequently take place; and prices rise more quickly than hourly money wages, as employment increases.

In seventeen of the eighteen countries² shown in the graphs on pages 125 and 126, hourly real wages rose and the volume of employment fell between 1929 and 1932. The movements are, however, less regular during the recovery in demand between 1932 and 1937. In France, employment continued to fall³ during these years, and hourly real wages continued to rise. In ten⁴ of the countries employment rose and hourly real wages fell (or, as in Latvia, remained unchanged) between 1932 and 1937. In the remaining seven countries, both

¹ Cf. *The International Labour Office Year-book, 1938/39*, pages 214-223.

² In the remaining country — Japan — information about movements in the real wage rate is not available before 1932.

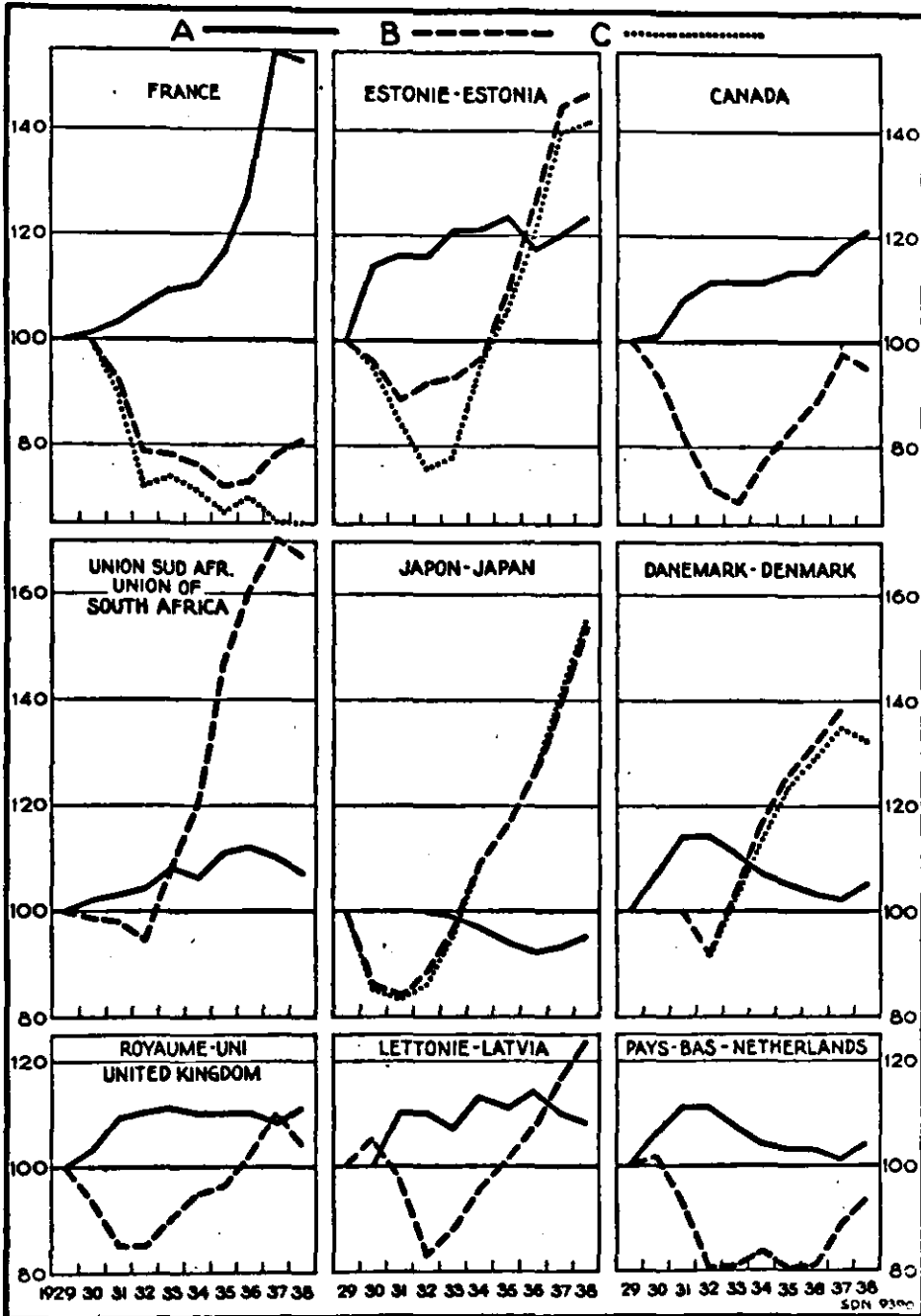
³ This is more marked if attention is paid to the total number of hours worked rather than to the total number of workers employed. The introduction of the forty-hour week caused the total number employed to rise between 1936 and 1938, although there was actually a reduction in the total number of hours worked.

⁴ Latvia, Czecho-Slovakia, Denmark, Germany, Hungary, Japan, the Netherlands, Sweden, Switzerland and the United Kingdom.

Wages and Employment.

(Base: 1929 = 100.)

A Hourly real wages.^a B Number in employment.^b
C Total hours worked.^b



^a United Kingdom: Weekly rates. Japan: Daily earnings, 1932 = 100. Latvia: 1930 = 100.

^b France: 1930 = 100. Denmark: 1931 = 100.

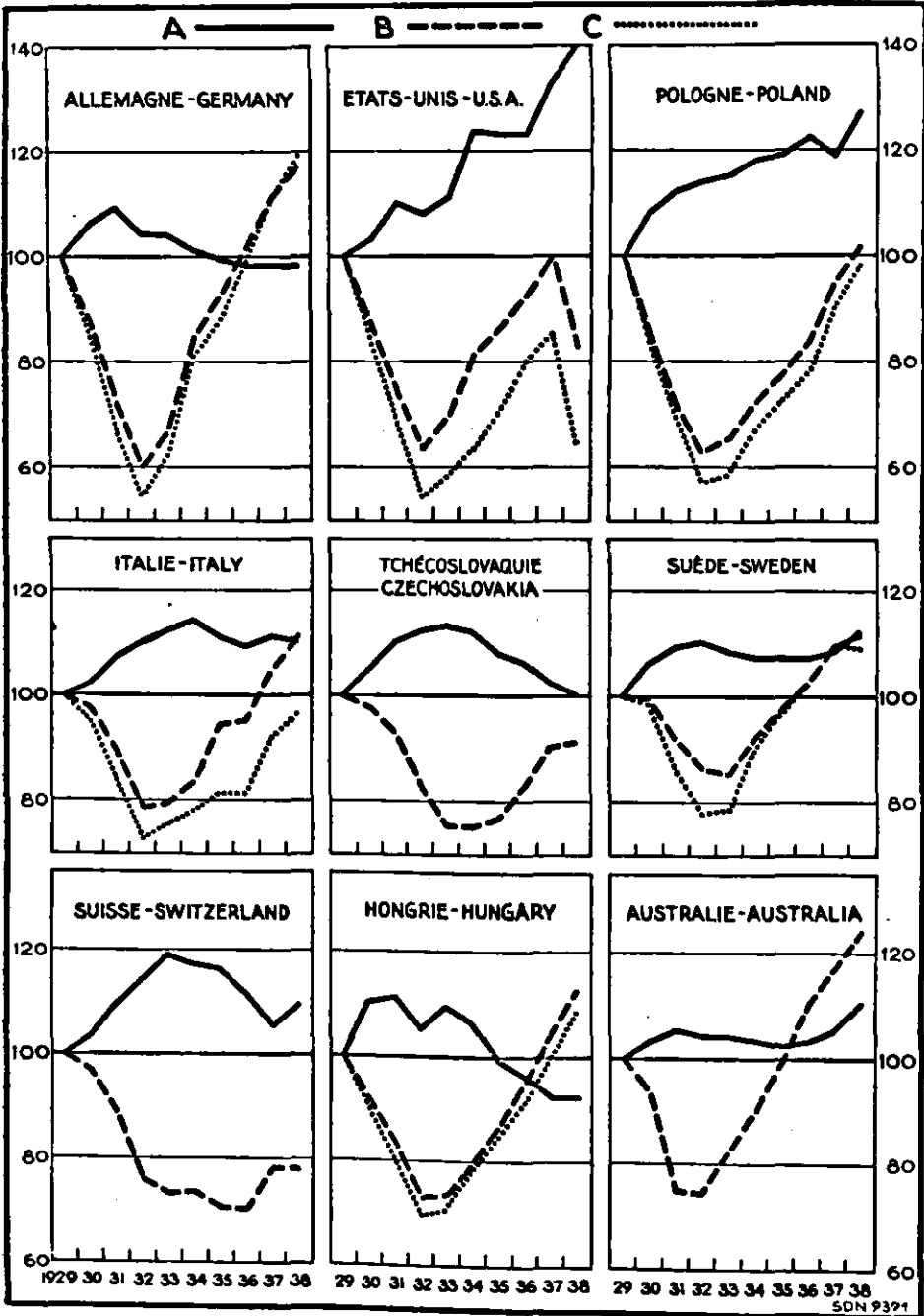
Wages and Employment.

(Base: 1929 = 100.)

A Hourly real wages.

B Number in employment.

C Total hours worked.



employment and hourly real wages rose during these years. But, even in these countries, the more normal relationship between employment and hourly real wages exerted some influence. For, in five¹ of these seven countries, the rise in hourly real wages was greater during the three years of falling employment from 1929 to 1932 than during the five years of rising employment from 1932 to 1937. The United States of America, however, seems to be little affected by this relationship between hourly real wages and employment. From 1929 to 1938, hourly real wages rose rapidly, although somewhat irregularly, in a way which had little connection with changes in the volume of employment, which fell between 1929 and 1932, rose between 1932 and 1937 and subsequently fell again between 1937 and 1938.

UNEMPLOYMENT AND LABOUR SHORTAGES

Recent changes in the degree of unemployment, as measured by the percentage of workers unemployed, are illustrated in the table on page 128. For every country shown there for which the information is available, there was a rise in the unemployment percentage between 1929 and 1932, and — except in the Netherlands and Poland — a fall between 1932 and 1937.

Between 1937 and 1938, with the onset of the recent business recession, the unemployment percentage rose again for the world as a whole. In some countries, such as Germany and Japan, the percentage continued to fall to exceptionally low levels; but, in Belgium, Canada, Switzerland, the United Kingdom and the United States, there were substantial increases as a result of the recession.

The unemployment percentages remain at present on a considerably higher level than in 1929. For the world as a whole, the degree of unemployment in 1937 and 1938 was about twice as great as in 1929. This phenomenon may in part be due to the fact that existing unemployment is now more fully registered in the various national statistics. But, in large measure, it marks a real change in economic conditions: in certain important industrial countries, such as the United States, full recovery from the post-1929 depression had not been achieved by 1937; and, in a number of other countries, such as the United Kingdom, the post-1929 depression had left behind it serious unemployment in special areas or in special industries, as a result of structural changes in industry. The rise in unemployment percentages since 1929 is particularly marked in Belgium, Canada,

¹ Australia, Canada, Estonia, Italy and Poland.

Percentage of Workers unemployed.

	1929	1932	1937	1938
World index	5.4	21.1	10.1	11.4
Australia	11.1	29.0	9.3	8.7
Austria	12.3	26.1	20.4	15.3*
Belgium	1.9	23.5	13.1	17.6
Canada	4.2	26.0	12.5	15.1
Czecho-Slovakia	2.2	13.5	8.8	8.5 ^a
Denmark	15.5	31.7	21.9	21.4
France				8.0 ^b
Germany	9.3	30.1	4.6	2.1
Japan	4.0	6.8	3.7	3.0 ^c
Netherlands	5.9	25.3	26.9	25.0
Norway	15.4	30.8	20.0	22.0
Poland	4.9	11.8	14.6	12.7
Sweden	10.7	22.8	11.6	11.8
Switzerland	3.5	21.3	12.5	13.1
United Kingdom	10.4	22.1	10.5 ^c	12.6 ^c
United States of America ^d	1.0 ^c	24.9	13.2	19.8

- ^a Provisional.
- ^b Based on the first eight months of 1938.
- ^c Figure quoted in the report by M. Daladier and M. Reynaud in the *Journal officiel*, November 12th, 1938. Includes wholly and partially unemployed.
- ^d Including agriculture.
- ^e National Industrial Conference Board.

Source: I.L.O. *Year-book of Labour Statistics, 1939.*

Czecho-Slovakia, the Netherlands, Norway, Poland, Switzerland and the United States. Only in Germany and Japan, whose controlled economies have become dominated by the activity of war or of war preparations, and in Australia has there been any reduction in the unemployment percentage since 1929.

Great caution is needed in making international comparisons of the percentage of workers unemployed owing to differences in the methods of computing these figures. But, after making every allowance for such differences, certain striking divergencies remain. In countries such as Germany and Japan, where a high level of economic activity has been reached and the armed forces have simultaneously been considerably expanded, the percentage of workers unemployed has been reduced to a very low level. Australia, Czecho-Slovakia and France are the only other countries in the table, in which the unemployment

percentage was less than 10% in 1938.¹ In countries such as Denmark, Norway, the Netherlands and the United States, from one-fifth to a quarter of the available workers are unemployed.

The distribution of unemployment is uneven, not only as between different countries, but also as between different occupations within the different countries. The expansion of rearmament programmes in a number of countries has given rise to labour shortages in particular industries and occupations, even though the general level of unemployment remains comparatively high. The table on page 130 illustrates the way in which the demand for labour has increased in industries closely connected with rearmament more rapidly than in industries serving the ordinary consumption needs of the public. In the case of all the five countries shown there, the demand for labour in the metallurgical and engineering industries has expanded rapidly, while the demand for labour in the industries producing food and clothing has remained comparatively stable in recent years. It must be remembered that the heavy industries producing durable goods which are used for capital construction normally fluctuate much more than the industries producing goods for current consumption; and some part of the greater expansion of the metallurgical and engineering trades between 1934 and 1938 is a normal example of this phenomenon. But this explains only a part of the development. In France, for example, there has been a marked expansion of employment in the industries closely connected with rearmament, even though there was little, if any, general economic recovery between 1934 and 1938. The rapid expansion in the demand for labour in the production of aircraft in the United Kingdom, in engineering in Italy and Japan and in machinery in Germany are, in large measure, the result of recent rearmament programmes.

Labour shortages have become very apparent in Germany, where many measures have been taken recently to organise the labour market in such a way as to make the fullest use of the available labour resources.² The employment of skilled workers is carefully controlled through the labour exchanges. In March 1938, the labour exchanges were empowered to issue

¹ The unemployment percentage in France was comparatively low, although industrial production in 1938 was still considerably below the 1929 level. Two special factors have tended to reduce redundant supplies of labour. In the first place, the temporary immigration of foreign workers which took place on a large scale when the demand for labour was high was much reduced when the demand for labour slackened (cf. Chapter VI, page 163), and, secondly, reduced hours of work helped to spread the available work over a larger number of workers.

² Cf. Helmut VOLLWEILER: "The Mobilisation of Labour Reserves in Germany", *International Labour Review*, October and November 1936.

Numbers in Employment in Various Industries.

(Base: 1934 = 100.)

		1936	1937	1938
France:	Metallurgy	103	122	128
	Metal-working	100	110	124
	Clothing	97	96	89
	Food	100	100	99
Germany:	Iron and metal production	134	147	158
	Machinery	142	163	182
	Clothing	103	110	112
	Food	101	105	106
Italy:	Iron metallurgy	137	148	152
	Engineering shops (specialised).	191	225	238
	Cotton	100	115	122
	Macaroni	116	120	117
Japan:	Mechanical engineering	132	166	250
	Tools and instruments	133	162	216
	Spinning	105	112	105
	Food and drink	110	115	125
United Kingdom:	Iron and steel	113	128	108
	Motor vehicles, cycles and aircraft	120	137	146
	Tailoring	102	106	101
	Boots and shoes	105	108	99

Source: I.L.O. *Year-book of Labour Statistics, 1939.*

written instructions to any particular undertaking forbidding it to engage workers without permission. In June 1938, powers were taken to require any German citizen to work for a limited period on a prescribed job or to undergo a special course of occupational training for work of political importance: and this power was extensively used to conscribe labour for the construction of fortifications in the west of Germany. Since March 1938, in order to organise the resources of new entrants to industry, all young children as they leave school have to be reported to a labour exchange. Measures have also been taken to restrict

changes of employment in occupations in which there is a shortage of skilled labour.

Certain new sources of labour have been tapped. In particular, women are now encouraged to enter into employment, whereas, in the earlier years of the present regime in Germany, measures had been taken to remove women from employment in order to make room for unemployed men. The regulation that women who had received marriage loans should not seek employment was removed in October 1937. In February 1938, a year of compulsory service for women was initiated. Young women could no longer be engaged in certain consumption industries¹ unless they had spent a year in domestic service or in agriculture or two years in certain nursing or educational professions. In June 1939, the year of labour service was made compulsory for all unmarried women under twenty-five years. Measures were taken in December 1937 and January 1938 to impose a new tax on itinerant trades and to refuse or withdraw permits for itinerant occupations in the case of men who could usefully be employed elsewhere. Early in 1939, it was decided that Jews who had previously been thrown out of work as a result of the Government's purge of industry and the professions should be conscribed for labour.

The existing labour resources have been more fully utilised by extensions of the hours of work, as will be seen in more detail in a later section of this chapter. Overtime has increased in the industries in which there is an acute shortage of labour; and producers in the textile and leather industries have been instructed to release workers by reducing short-time.

The increased demand for labour in industry has quickened the exodus from the rural areas, and has thus intensified the scarcity of agricultural labour. In recent years, many measures have been taken to meet this problem. Foreign agricultural workers have been imported temporarily to meet seasonal pressures; agricultural employers have the right to retain the employment books of any worker who leaves his employment without due cause before the proper time, and this effectively prevents any such worker from obtaining alternative employment; men and women in the labour camps are used for temporary agricultural work; and unemployment relief may be refused to workers who are capable of employment in agriculture. Reference has already been made to the order of March 1938 which requires women to perform a year's labour in agriculture or domestic service if they wish to seek employment in certain industries.

¹ Clothing, textile and tobacco industries, in which there is a high percentage of female employment and no shortage of labour.

In the United Kingdom, as has been mentioned in Chapter I (pages 25 and 26), it was estimated that the increased level of expenditure upon armaments might give rise directly and indirectly to an additional demand for as many as 1,500,000 workers. In January 1939, there were approximately 2,000,000 registered unemployed, but this figure much exaggerated the available resources of labour which could readily be brought into employment. It has been estimated¹ that this figure contained some 500,000 persons who were temporarily out of work because of brief and normal interruptions in their work, some 50,000 to 60,000 women who had retired from work but maintained their names on the register of the unemployed to maintain certain pension rights, and some 200,000 elderly and infirm persons who were no longer employable. In addition, the expansion of the armed forces and the introduction of military conscription in May 1939 may account for another 200,000 men. During the first six months of 1939, the number of registered unemployed fell by more than 700,000; and some shortages of labour were reported in skilled occupations, which had been particularly affected by rearmament. By July 1939, the number of unemployed available for industrial employment was lower than it had been at any time since November 1929.

In France, in March 1939, measures were taken by decree to organise the available supply of labour for the national defence industries. Employers were prohibited from employing without permission of a labour inspector any worker not already out of work, in order to reduce the competition for such labour; and any unemployed person refusing work related to national defence was to lose all right of benefit for one year.

In Japan also, the expansion of the armed forces and the production of arms and munitions for the prosecution of the war against China have already led to serious shortages of labour. Before the outbreak of the war, unemployment was already low and industrial expansion had absorbed the greater part of the available supplies of labour. It has been estimated² that, between October 1930 and October 1936, 2,742,000 persons were absorbed into employment out of a total labour reserve of 2,998,000, of which 1,693,000 became available from the natural increase of population and 1,305,000 from unemployment existing in October 1930. It was reported in June 1938 that some 700,000 to 800,000 workers in industries which were not essential for war purposes had been thrown out of

¹ Cf. estimates of Sir Ronald DAVISON, *The Times*, April 28th, 1939; and *The Economist*, May 6th, 1939.

² Cf., supplement to the *Oriental Economist*, "Japan in 1938".

employment as a result of restrictions imposed upon the use of raw materials which were required for war purposes; but considerable difficulties were experienced in transferring such labour to war industries. To meet these difficulties, a number of measures have been taken. The employment exchanges have been nationalised to arrange for the retraining of such men, and generally to organise the labour market to meet the existing shortages. Technical students have been taken early from the universities and have been drafted directly into industry. A national register has been organised at first of certain classes of skilled workers and later of the whole of the working population.

In the Union of Soviet Socialist Republics also, measures have been taken to organise the labour market in such a way as to make fuller use of the available resources, by preventing the abuse of workers' privileges and by reducing the rapidity of the labour turnover. Unjustifiable absence from work or bad timekeeping may be punished by dismissal. As from the beginning of 1939, a worker who wishes to leave his undertaking must notify the management a month in advance; and if he lives in a house reserved for workers of the undertaking, he must vacate it within ten days of leaving his work. In addition, the qualifying period for earning the privilege of holidays with pay has been extended to eleven months of continuous work in the same undertaking.

HOURS OF WORK

A number of conflicting influences have affected the hours of work in recent months. The recession in business activity in many countries during 1937 and 1938 has led, as it normally does, to a certain reduction of hours of work in those industries which meet a reduced demand for their product by means of working short-time. In a few countries, the systematical reduction of hours of work as a measure of social policy has made further progress. On the other hand, France has considerably modified the policy of reduced working hours; and the shortages of labour, which have resulted from the intensification of public expenditure on armaments, have led to the lengthening of hours of work in certain industries in other countries.

The sharp reduction in the hours of work in the United States between 1937 and 1938 was due in the main to the business recession; but the movement for reduced hours of work has made great progress in that country. By the Fair Labour Standards Act of 1938, maximum hours of work are to be reduced by stages from forty-four hours a week in October

Hours worked per Worker in Industry.

		1929	1932	1937	1938
Estonia	Hours per day	8.18	7.86	8.03	8.09
Germany		7.67	6.91	7.68	7.75
Hungary		8.97	8.53	8.59	8.40*
Japan		9.27	9.10	9.32	9.33
Finland ^a	Hours per week	46.5	45.45	47.55	...
France . . . . .		.	43.7	40.2	38.7
Netherlands ^b . . . . .		.	.	47.1	...
Norway . . . . .		.	.	44.9	44.1
Poland		44.7	40.7	43.3	43.7
Sweden . . . . .		.	.	47.2	46.3
United States		48.3	34.8	39.2	34.4
Italy	Hours per month	182	168	163	159

^a Provisional.

^b Based on hours of work per fortnight.

^c Amsterdam. Average July to December.

Source: I.L.O. Year-book of Labour Statistics, 1939.

1938 to forty hours a week in October 1940 for workers engaged in inter-State commerce or in production for inter-State commerce; and overtime wages are to be paid at a rate 50% greater than the normal wage rate. Approximately 11,000,000 persons are reported to be covered by this enactment, and, of these, more than 5,000,000 will be affected by the reduction of maximum hours of work to forty a week. In Luxemburg, an order of October 1938 provided the legal basis for a gradual reduction of hours of work to forty a week. In New Zealand, the forty-hour week which was recently introduced has been maintained with a few minor exceptions. In a number of countries of South America — Bolivia, Colombia and Venezuela — new labour codes are in preparation which take the forty-eight-hour working week as a basis.¹

While the movement for shorter hours of work has thus made progress in certain cases, in general it has been hampered by international political developments, which have necessitated large increases in production for military purposes. Thus, at the International Labour Conference in June 1939, it was decided that the question of the generalisation of the reduction

¹ Cf. The Report of the Director of the International Labour Office, 1939, page 51.

of the hours of work should be removed from the agenda of the Conference until times were more propitious for its successful discussion. Important modifications of the forty-hour week have recently taken place in France. In April 1938, hours were extended to forty-five a week in nationalised aviation industries; in May, the procedure for making up lost time and for granting overtime was simplified; and, in September, larger allowances of overtime were granted to industries in which there was a shortage of skilled labour. More important modifications were introduced in November 1938, when the five-day week was abolished in favour of six working days a week, the procedure for overtime was further simplified, the number of hours of overtime was no longer limited, and overtime rates of pay were lowered to non-prohibitive levels. In March 1939, it was decreed that hours of work might be extended to sixty a week in establishments working for national defence; and finally, in April 1939, hours of work up to forty-five a week were permitted without payment of overtime rates of wages. In the table on page 134, it can be seen that hours of work in France fell between 1937 and 1938. This development is largely due to the fact that the forty-hour week, which was introduced in stages, did not cover the whole of industry in the first months of 1937. In fact, throughout 1938, there was a progressive relaxation of the rules limiting hours of work.

In Germany and Japan, the requirements of production for military purposes have led to an increase in the hours of work in the industries closely connected with the production of armaments.

Hours worked per Worker per Day.

	Germany		Japan	
	Engineering construction	Textiles	Engineering and tools	Textiles
1929. . . .	8.02	7.46	8.97	9.83
1937. . . .	8.31	7.18	9.53	9.67
1938. . . .	8.34	7.32	9.60	9.63

As the above figures show, in both countries, hours of work increased between 1937 and 1938 to a figure above the 1929 level in the engineering trades, which are much affected by the demand for armaments; on the other hand, in the textile industry, hours of work are still below the 1929 level.

THE WORKERS' STANDARD OF LIVING

During the period covered by this *Survey*, economic and social problems have been increasingly affected by political tension and by measures of military and economic defence. The development of such measures is bound finally to react unfavourably on the workers' standard of living; and it has already in some cases hampered social and economic progress, as, for example, in checking the movement towards shorter hours of work. Yet, in spite of the fact that it has prevented standards of living from rising as quickly as would otherwise have been possible, it is still possible to record many important advances towards higher standards.

The total real wage income of workers is liable to be depressed by low wage rates, short-time and unemployment. The following figures illustrate for a number of countries the way in which changes in hourly real wages, employment and hours of work have affected the total wage income of industrial workers since 1929.

Hourly Wages, Employment, Hours of Work and Total Wage Income in Industry.¹

(Base: 1929 = 100.)

	Hourly real wage per man		Numbers employed		Hours worked per man		Total real wage income	
	1937	1938	1937	1938	1937	1938	1937	1938
France	148 ^a	137 ^a	78 ^b	81 ^b	84 ^b	81 ^b	96 ^c	89 ^c
Germany	97 ^c	99 ^c	111 ^d	117 ^d	100	101	107 ^e	118 ^e
Japan	98	90	140	154	101	101	138 ^e	140 ^e
Poland	119 ^d	127 ^d	94	102	97	98	97	112
Sweden	108 ^c	112 ^c	109 ^d	112 ^d	—	—	118 ^e	122 ^e
United Kingdom	111 ^c	111 ^c	110	104	—	—	—	—
United States	133	140	100	82	81	71	109	85

^a Paris.

^b 1930 = 100.

^c Series including mining and other non-industrial branches.

^d Series including also mining.

^e Approximate data calculated by the International Labour Office by multiplying indices of hourly real wages by indices of total hours worked.

Sources: *International Labour Review*. — For United Kingdom, hourly wages: E. C. RAMSBOTTOM: *Journal of the Royal Statistical Society*, Part II, 1939, pages 289-291.

¹ In view of divergencies in method and scope of the series used, the data must be regarded as giving only approximate indications. Moreover, the figures relate mainly to workers in industry only.

In the case of Germany and Japan, hourly real wages remain at a comparatively low level; but these relatively low rates of wages have been combined with a considerable increase of employment. In both countries, the increase in employment has more than counterbalanced the diminution in hourly real wages, and total wage income is above the 1929 level.¹ On the other hand, hourly wage rates have risen very rapidly in France and the United States. In these two countries, employment has remained below the 1929 level and at the same time hours of work have also been drastically reduced. These developments have restricted total real wages in both these countries. Poland has experienced a considerable rise in hourly real wages, which has been the main factor affecting the total real wage income of industrial workers since 1929. In the United Kingdom — as far as it is possible to see it from the available figures — and in Sweden, there has been an appreciable rise in total real wage income, which has occurred as a result of the combination of more moderate increases both in hourly real wages and in employment.

While the real earnings of labour remain the primary factor affecting the welfare of the working populations, other factors have become of increasing importance in recent years. Through schemes of social insurance and other measures, a general system is being developed in the majority of countries for the support for workers in unemployment, sickness and old age. For many years, public action has been taken in a large number of countries to improve the housing conditions of the working class. More recently, increasing attention has been paid to the extension of leisure and of the opportunities for the enjoyment of leisure by workers, and to the fight against malnutrition. In all these spheres, considerable progress has been made, even in recent months, when the attention of statesmen and available public funds have been increasingly directed towards the organisation of military and economic defence against the threat of war.

The scope of social insurance ² has been extended in a number of countries. In New Zealand, recent social security legislation provides for insurance against unemployment and ill-health

¹ It is possible that the figures somewhat exaggerate the level of real wage income in Germany, since the deterioration in quality which has probably taken place in the case of certain goods is not revealed in the cost-of-living figures by means of which real wages are computed. Moreover, in 1936 legal deductions from wages for taxes and social insurance represented 12% of wages (cf. *Halbjahresbericht zur Wirtschaftslage 1937-38*); and it has been estimated (cf. C. W. GUILLEBAUD, *Germany's Economic Recovery*) that total deductions, including unofficial contributions, represent between 15% and 20% of wages.

² The Report of the Director of the International Labour Office, 1939, and *The International Labour Office Year-book, 1938/39*.

and for the payment of pensions for old age, for premature loss of earning capacity and for dependents in case of the death of a wage-earner. In Australia, a recent compulsory federal insurance scheme provides for medical benefit in the case of ill-health and for pensions for old-age and for wage-earners' survivors. The Social Security Scheme in the United States has developed in a number of ways: unemployment benefits were being paid in most States in 1938, and will be paid in all States and territories of the Union before the end of 1939; a special Act for unemployment insurance of railways workers has been passed; and it has been officially proposed that insurance for old-age pensions should be extended to farm-workers, domestic servants, seamen and other groups which have so far not been covered.

In addition to these more general developments, a number of measures have been taken to extend particular forms of social insurance. Extensions of unemployment insurance have taken place in Norway and South Africa. In the Argentine, Canada and France, improvements and extensions have been carried out in the existing systems of insurance against industrial accidents. In the United Kingdom, the age for admission to health insurance has been lowered from 16 to the school-leaving age of 14 years, so that no gap now exists between the medical services of the school and of the insurance scheme. In Greece, a general scheme of health insurance has been introduced, and the necessary medical service has been established. Health insurance has been improved or extended in France, Italy, Latvia, Lithuania, Roumania and Japan; and the introduction of compulsory sickness insurance is being considered in Brazil. Compulsory old-age insurance has been introduced for agricultural workers in Hungary; and, in Yugoslavia, all workers in industry and commerce are to be insured against old-age, invalidity and death. Improvements in existing schemes for old-age pensions are reported in Brazil, Luxemburg, Belgium, Denmark and France; and a new national insurance scheme for old-age and invalidity for all adult inhabitants is about to be inaugurated in Finland.

In many countries, public action has been initiated or developed recently to improve the standards of housing.¹ In the space available in this *Survey*, it is impossible to do more than give a few illustrations of the very varied methods which have been adopted for this purpose. In a certain number of countries, including Brazil, Chile, Colombia and Roumania,

¹ Cf. League of Nations: "Urban and Rural Housing"; and *The International Labour Office Year-book, 1938/39*.

use is now being made of the funds accumulated in social insurance funds for the purpose of financing the building of houses. In Roumania, a tax is also to be levied on all new buildings to finance the construction of cheap houses; and, in Colombia, an Act has been enforced to compel municipalities to devote 2% of their budgets to the provision of workers' houses, and, since October 1938, material imported for co-operative building societies has been exempt from duty. In New Zealand, the Reserve Bank has supplied the State Housing Department with £5,000,000 to form a fund to be devoted to building. In Belgium, an Act of June 1938 empowered the National Society for Cheap Houses and Dwellings to contract a loan of 350,000,000 francs under State guarantee, and a plan has been drawn up for the abolition of 30,000 slums.

In Denmark, an Act of April 1938 provided for the granting of State building loans, and the rents of the houses built by means of these loans may be reduced by as much as 50% for the benefit of tenants with large families. In France, various recent decrees provide for the reconditioning of houses, the granting of loans to the communes for slum clearance, and the relief of taxation for the investment of funds in workers' housing and for new buildings and repairs. Perhaps the most important recent developments in the campaign for better housing were the amendments of legislation on housing in the United States; these amendments increased the annual contributions of the Federal Government to building of houses, the total loans which the Housing Authority may advance, and the proportion of mortgage loans on new houses which could be guaranteed. It has already been shown in Chapter I that these measures were of importance in stimulating the recent building activity in the United States.

In recent years, rapid progress has been made in the organisation of paid holidays for workers; and this has been accompanied by the development of facilities for the use of leisure and by the co-ordination of bodies which deal with the problems of workers' spare time.¹ In 1920, only one country had adopted legislation providing holidays with pay for wage-earners. By 1930 seven countries, by 1935 fourteen countries and by 1939 as many as twenty-three countries had passed such legislation. In addition, there are now fourteen other countries which have passed legislation of a less broad scope which ensures holidays with pay to certain classes of workers; and, in many important countries, the system of paid annual holidays is now widespread,

¹ Cf. *Report of the Director of the International Labour Office, 1939*, pages 70-72, and *The International Labour Office Year-book, 1933/39*, pages 95-105 and 316-324.

even though it is not legally enforced. In fact, the extension of workers' leisure is one of the most rapid and significant of social changes which has occurred in recent years. Last year, Denmark and Sweden granted holidays with pay of twelve working days; in the United Kingdom, an Act was passed which enables trade boards and agricultural wage committees to make provision for paid holidays for those whose wages they regulate; existing schemes of workers' holidays with pay have been liberalised or extended in a number of countries including Belgium, Estonia, Finland, France, Hungary, Ireland and Roumania.

This rapid development has raised a number of problems. The large scale extension of holidays necessitates the provision of facilities for the full enjoyment of increased leisure; and it has also become important to prevent an unbearable strain from being placed upon the transport and other holiday facilities during the short holiday period. The solution of this problem in turn raises further problems, such as the spreading of school holidays in a way which will enable different groups of working-class families to take their holidays at different times. In Belgium, a National Office for Workers' Holidays provides cheap tickets for travel, and it has been recommended that school holidays should be shifted in such a way as to spread workers' holidays over a longer period of the year. In Denmark, a national institute entitled "People's Holidays" has been set up to organise cheap travel, cheap accommodation and holiday homes and camps. In France, a Decree of November 1938 makes it possible to order a rotation between different undertakings in granting holidays to their staffs, and various unofficial measures have been taken to provide for facilities for the enjoyment of holidays and to develop workers' education. In Germany, the "Strength through Joy" organisation has been still further developed. The first vessel of the fleet for workers' cruises has been put into service; exchanges have been arranged with various countries, and, in particular, with Italy, for foreign travel; the network of youth hostels has been extended; the movement for workers' education has been developed; and village halls and libraries have been opened in various rural districts. In the United Kingdom, an inter-departmental committee has been set up to stimulate the co-ordination of the various problems of industry, education, transport and lodging which arise out of the extension of workers' holidays. In Italy, an international "Joy and Work" congress was held in Rome in June 1938, and exchanges of foreign travel for workers have been arranged with Germany and Hungary. In the United States, an association of recreation

workers has been formed to organise facilities for recreation in the United States, Canada and Mexico. In a number of countries, including Germany, the United Kingdom, South Africa, Australia and New Zealand, progress has recently been made in the movement for physical fitness.

Largely as a result of the interest raised by investigations undertaken by the League of Nations, increasing attention has been paid recently in a number of countries to the problems of malnutrition.¹ National Nutrition Committees have now been organised in more than twenty countries, while only three such committees, were in existence when the League of Nations' enquiry was started. It is impossible in the space available in this *Survey* to do more than select a few examples from the recent League survey of national nutritional policies, in order to illustrate the various types of measure which different countries have adopted. In the United Kingdom, milk is now provided free or at reduced prices to necessitous mothers and children; a scheme is in operation to provide milk cheaply in schools to children of school age; and a scheme, which now covers some 7,000 factories and 2,500,000 workers has been initiated to provide milk to workers at their work, and consequent improvements are already reported in reduced absence from work and better health among the workers. In Hungary, the Village Association of Hungarian Farmers and Land-workers distributes milk to children, the cost of which is defrayed partly by the Government and partly by local contributions. In France, milk dispensaries now distribute to certain children free food rations, appropriate to the age and state of health of the children affected; and subsidies are paid by the social insurance funds to canteens, holiday camps and similar institutions for children. In the Netherlands, food and clothing are distributed to elementary school children. In Latvia, family allowances have been allotted to agricultural labourers for children below the age of 10 years, and one of the expressed objects of the scheme is to improve nutritional standards.

Two interesting examples of measures to provide cheap food are the methods by which the United States and the Netherlands dispose of surplus food supplies. In the United States, the Federal Surplus Commodities Corporation disposes of commodities purchased by the Agricultural Adjustment Administration under its surplus purchase plan, and some of

¹ Cf. the final report of the Mixed Committee of the League of Nations on the Relation of Nutrition to Health, Agriculture and Economic Policy, 1937; Survey of National Nutritional Policies, 1937/38. League of Nations, 1938; International Labour Office Studies and Reports, Series B, No. 23, 1936, on Workers' Nutrition and Social Policy.

these supplies are given to State and local relief agencies for distribution to needy persons. In the Netherlands, certain surpluses of foodstuffs, including margarine, edible fats and vegetables, which cannot be marketed at remunerative prices, are now supplied cheaply to the poor. Other countries which have taken measures to provide cheap food include Norway, Yugoslavia, Uruguay, Venezuela and Egypt. In Yugoslavia, France, and Egypt, measures have recently been taken to improve the qualities of foodstuffs by the better supervision and inspection of food supplies. In Sweden, the United Kingdom, Hungary, Belgium, Norway, New Zealand and Iraq, better nutritional standards have been set, particularly in various public institutions, through the provision of advice on diets.

Chapter VI.

POPULATION AND MIGRATION

The nineteenth century was a period of rapid growth of population. As the following figures show, the population of the world has probably been at least doubled since the beginning of the nineteenth century. This growth of numbers occurred in all continents, and has continued up to the present. The

Estimated Population of the World.¹

1800	1900	1936	1937
	(000,000's)		
906	1,608	2,116	2,126

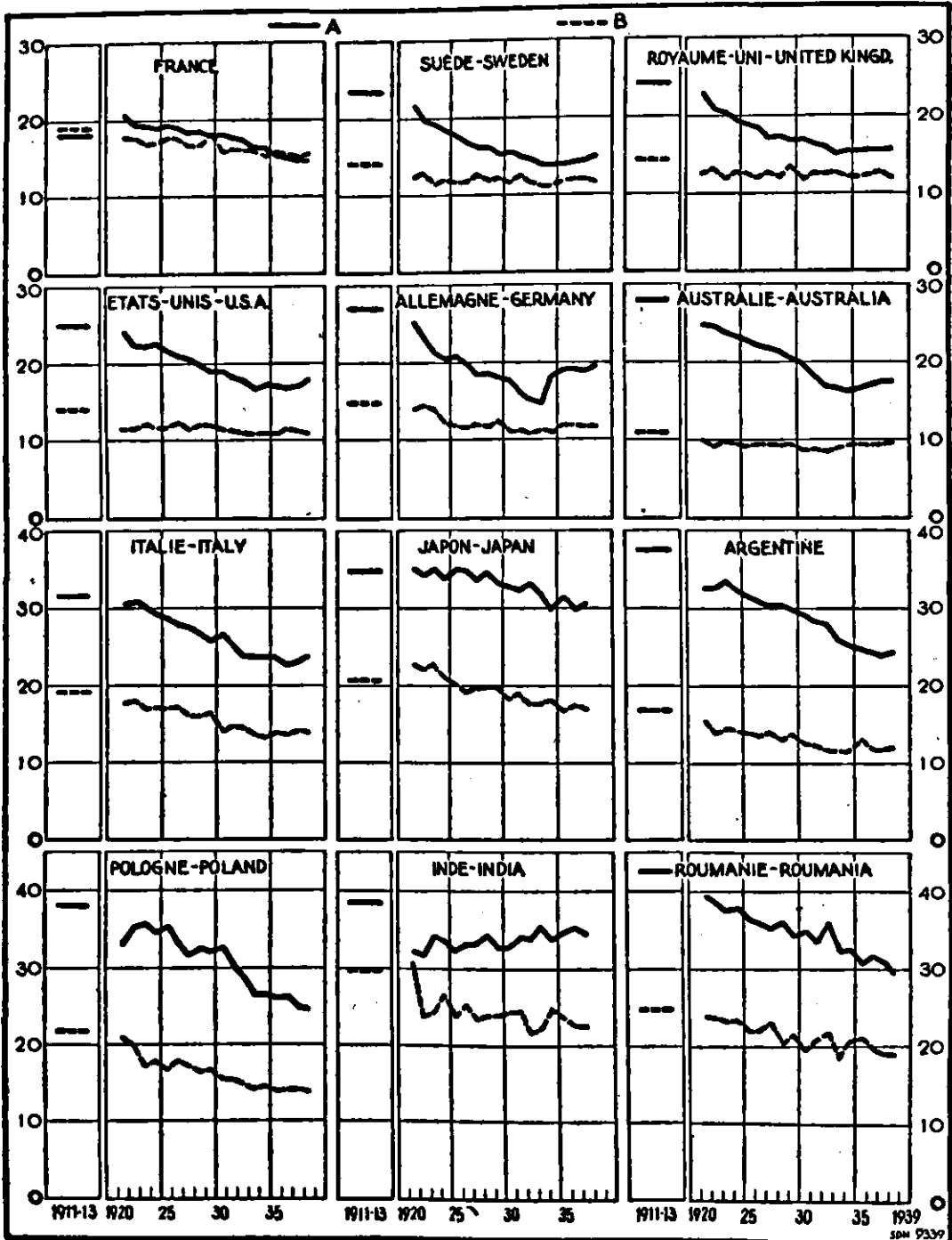
increase of population has been particularly rapid in the countries such as those of North and South America and of Australasia, into which there was heavy European emigration during the nineteenth century and the first years of the twentieth century. It was also rapid in many countries, such as the United Kingdom, in which these years witnessed rapid industrialisation.

In most countries, population is still growing; but, as will be seen later, there has been a very great change in the underlying trends of development. In certain countries, such as Japan and probably the Union of Soviet Socialist Republics, there is still a rapid increase in population, which is likely to continue for many years. To a less marked extent, this is also true of some countries of Eastern and Southern Europe. In some few countries, of which British India is the most marked example, it is probable that a more rapid population growth¹ is checked only by the scarcity of the means of subsistence in relation to an already excessive population. On the other hand, in such countries as those of Western and Northern Europe, the United States of America and some of the British

¹ The figures for 1800 and 1900 are based on estimates of Professor W. F. Willcox, revised by Professor A. M. Carr-Saunders; those for 1936 and 1937 are from the *Statistical Year-Book of the League of Nations*. The figures are necessarily only approximate estimates, and, particularly for the earlier years, are very uncertain.

Birth Rates and Death Rates.*

(Annual Births (A) and Deaths (B) per 1,000 of total population.)



* Figures taken from the *Statistical Year-Book of the League of Nations, 1938/39.*

Dominions, 'there is evidence that the population will sooner or later decline if present rates of fertility and mortality continue.

This change in the underlying trend of population growth has already had important economic effects; and these effects are likely to become increasingly important both internally in the countries concerned and also in the relations between different countries. But the fact that many populations have already ceased effectively to reproduce themselves is concealed by a continuation of population growth which, as will be seen later in this chapter, is due to special and temporary causes. People have become so accustomed to an economic structure which is based upon the experience of a century of rapid population growth that the importance of the economic effects of present population tendencies is often overlooked.

BIRTH RATES AND DEATH RATES

The natural increase of a population consists in the excess of births over deaths, and the most usual method of measuring population trends is to compare birth rates and death rates for each country. The diagram on page 144 shows birth rates and death rates immediately before the great war and annually since 1921 for a number of countries.

It will be seen that there has been an almost universal reduction in both birth rates and death rates since the great war, but that in nearly all countries the birth rate has fallen considerably more than the death rate. Thus the rate of natural increase of population has diminished in the majority of countries for which statistics exist; and this diminution has been marked in countries such as France, the United Kingdom, Sweden, the United States of America and Australia. Indeed, in France,¹ births have already fallen below deaths, and a natural increase of population has given place to a decrease. Even in countries such as Poland, Roumania, Italy and the Argentine, which still show a considerable excess of births over deaths, there has been a marked reduction in the rate of natural increase in recent years. In India and Japan, both of which countries also show a considerable excess of births over deaths, there has been no reduction in the rate of natural increase in recent years. Certain countries show some rise in the birth rate since 1932 and 1933, the worst years of the great depression; but, except in the case of Germany, whose experience

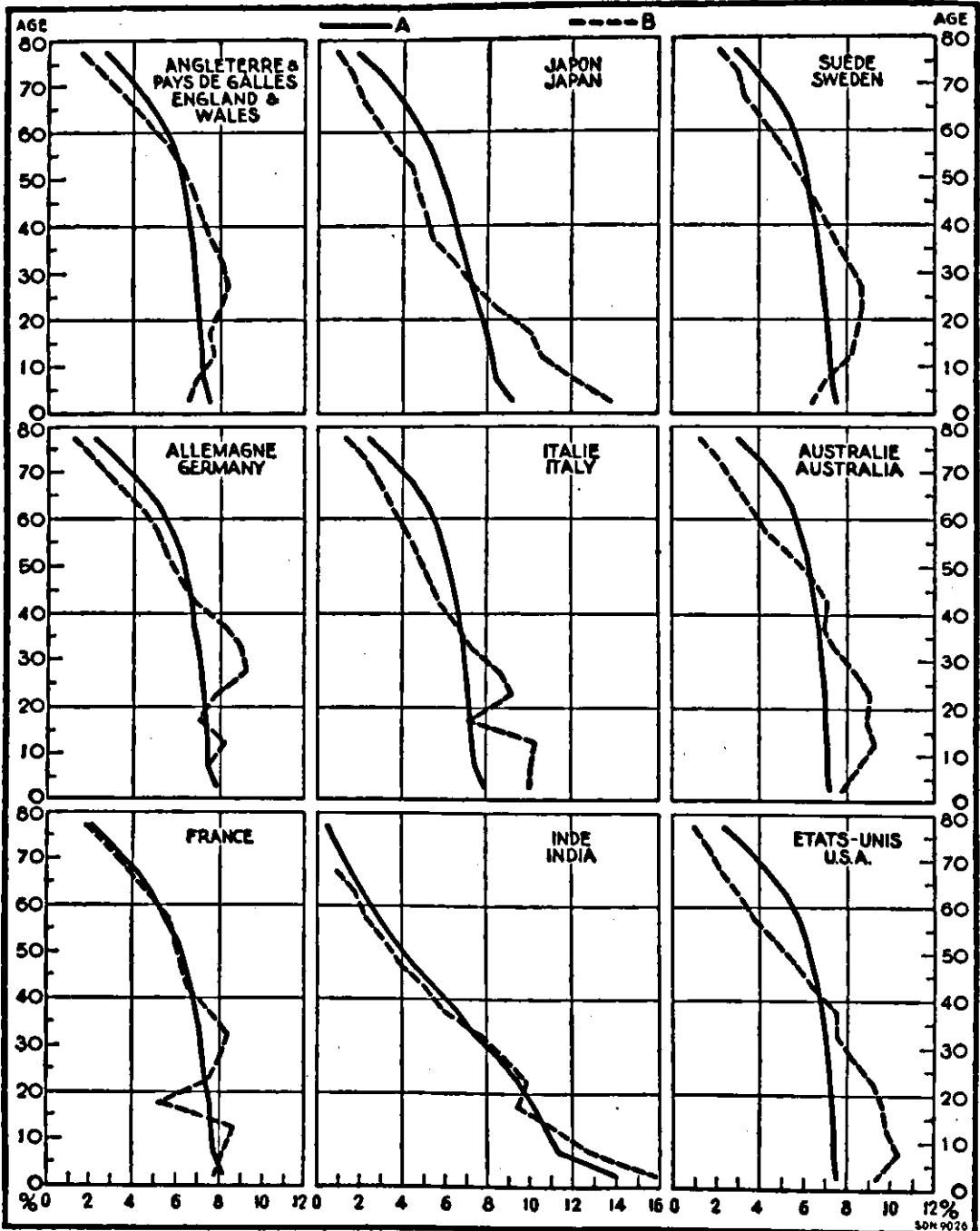
¹ France and Austria alone among the countries for which statistics are published in the *Statistical Year-Book of the League of Nations* showed an excess of deaths over births in 1937.

Actual and "Life-Table" Age-Distribution.¹

A "Life-table" population.

B Actual population.

Percentage of total population in each five-year age-group:



* England and Wales, Sweden, United States of America, Australia, India and Japan: female populations only. Age-distributions for the following years: England and Wales, A 1930-1932, B 1936; Japan, A 1926-1930, B 1930; Sweden, A 1926-1930, B 1935; Germany, A 1927, B 1937; Italy, A 1930-1932, B 1936; Australia, A 1932-1934, B 1937; France, A 1928-1933, B 1935; India, A and B 1931; United States, A 1929-1931, B 1930.

¹ The "life table" gives the chances of survival to different ages at current mortality. A "life-table" age-distribution shows the age-distribution of the population which would finally result from a constant number of annual births, if mortality at each age remained unchanged at the current level.

will be discussed later at greater length, this rise has been very slight.

The almost universal fall in birth rates is due to a great reduction in the size of the average family. This reduction in fertility has recently been much more marked than the reduction in mortality, which was the main cause of the great population growth of the nineteenth century. Indeed, while the nineteenth century was a period of rapid population increase due to reduced mortality, future years in many countries threaten to be a period of population decline due to reduced fertility.

THE CHANGING AGE-DISTRIBUTION OF THE POPULATION

In spite of the falling birth rate, births still exceed deaths in nearly every country; but, nevertheless, there is evidence that, in many of these countries, the population has in reality ceased to reproduce itself. For the birth rates and death rates depend upon the age-distribution of the population, which may be temporarily abnormal. The death rate is heaviest among infants and the old, whereas only women in the reproductive ages can give birth to children. For this reason, a population which for any temporary reason contains a small proportion of infants or of old persons and a large proportion of women in the reproductive ages, will show a low death rate and a high birth rate. If mortality and fertility do not change, such a population will display a rising average death rate and a falling average birth rate as the large percentage of persons in the reproductive ages grow older.

In many countries of Western European culture, the populations at present contain a small proportion of old and young persons, and a high proportion of persons in the intermediate ages. This is so because the birth rate was high in past years, and has fallen in recent years, so that there is a large number of persons who are now in the reproductive ages. The graphs on page 146 enable a comparison to be made between the actual and the "life-table" age-distribution of population in a number of countries.

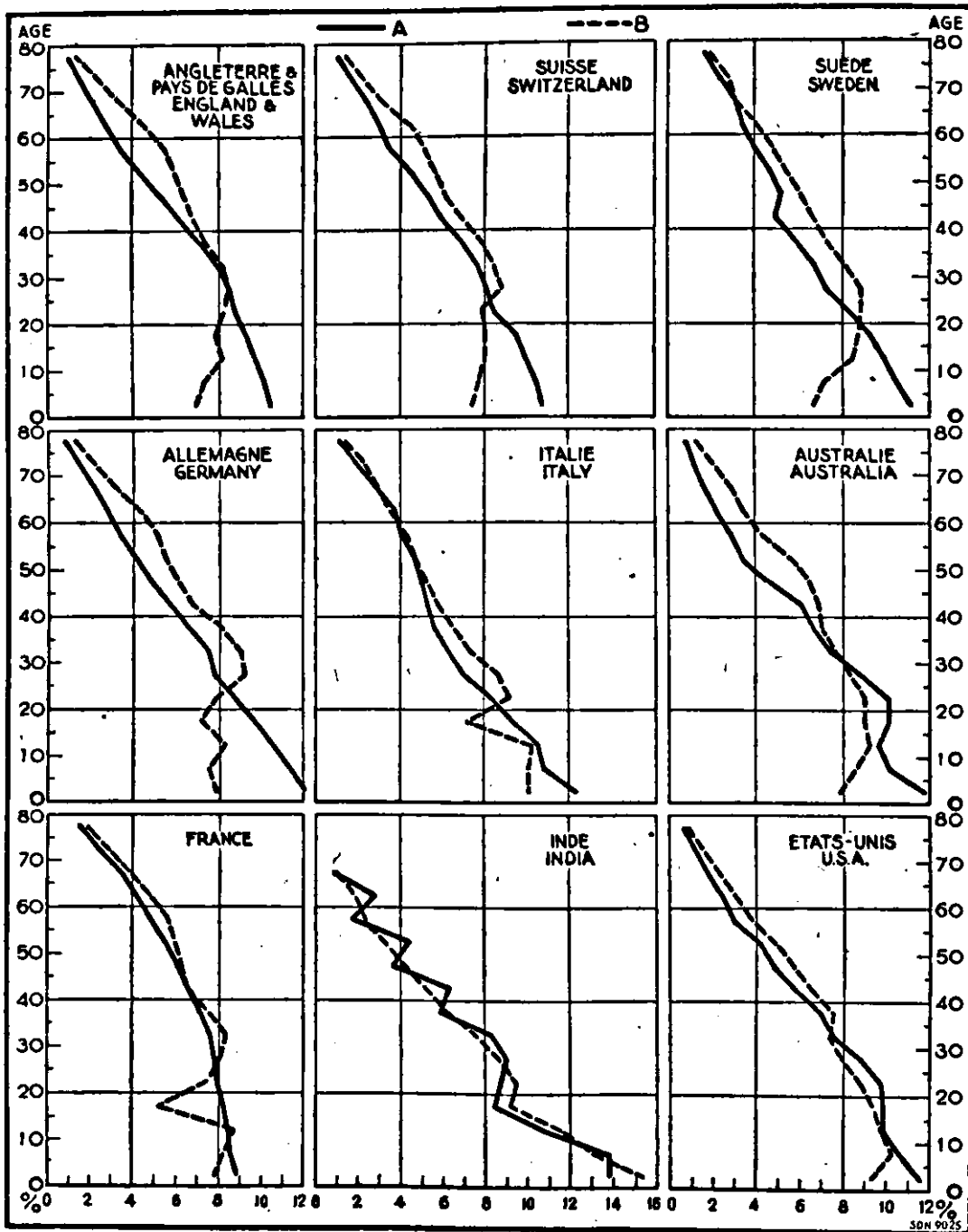
The graphs suggest that the populations of England and Wales, of Sweden, and, to a lesser extent, of France are failing to reproduce themselves; for they contain an abnormally large proportion of persons in the reproductive ages and, in spite of this, an abnormally small proportion of infants. Moreover, in England and Wales, Germany, France, Australia and Sweden, the number of infants is less than the number of persons some twenty or thirty years older, so that, even if none of these

*Pre-war and Recent Age-Distributions.**

A Pre-war population.

B Recent population.

Percentage of total population in each five-year age-group:



* Age-distributions for the following years: England and Wales, A 1911, B 1936; Switzerland, A 1910, B 1937; Sweden, A 1910, B 1935; Germany, A 1910, B 1937; Italy, A 1911, B 1936; Australia, A 1911, B 1937; France, A 1911, B 1935; India, A 1911, B 1931; United States, A 1910, B 1930. Cf. Table 3 of the *Statistical Year-Book of the League of Nations, 1938/39*. The irregularities in the pre-war curve for India are due to the tendency to report ages approximately in the nearest round number.

infants were to die before reaching 20 or 30 years of age, they would not be sufficient to replace their elders. In these same countries, with the exception of France, there is also at present an abnormally small proportion of old persons. These facts suggest two important consequences. First, as the high proportion of persons in the reproductive ages grow old, births are likely to fall and deaths to rise to such an extent that the total population will decline. Secondly, apart from the actual decline in total numbers, the population will become older and there will be a smaller proportion of persons of working-age and a larger proportion of old persons to be supported in retirement.¹

On the other hand, in British India, the actual age-distribution does not vary very considerably from the normal. In Italy, there is still a large proportion of infants in the population, although the total number of persons in the reproductive ages is not excessive; and this suggests that fertility is still more than sufficiently strong to offset mortality. But it is Japan which shows most clearly the age-distribution of a population which is likely to continue to expand for many years; for, in this case, a very large proportion of infants is produced by a population which contains a small proportion of persons in the reproductive ages.

The ageing of the population which, as has been seen, is likely to occur in the populations of Western and Northern Europe, Northern America and Australasia, has already gone some way, as can be seen from the graph on page 148.

In the United States, Australia, Sweden, England and Wales, Germany and Switzerland, there is already an appreciably smaller proportion of children in the population than before the great war. In most of these countries, there is at present an appreciably larger proportion both of persons of working-age and of old persons, and in future years the proportion of old persons may be expected to gain considerably at the expense of persons of working age. In France and Italy, the ageing of the population is also apparent, although the change has been less marked. In British India, there has been little change in the age-distribution.

MORTALITY

The decrease in mortality may conveniently be measured by the lengthening of the expectation of life at birth, which is illustrated by the figures on page 150.

¹ The graphs show a peculiarly small proportion of persons in the age-group 15 to 20 in Germany, Italy, France and, to a lesser extent, England and Wales. This is to be explained by the peculiarly low birth rates ruling during the great war.

Expectation of Life at Birth.¹

(Number of years: Females only.)

	1901-1910	1920-1922	1932-1934
Australia	59	63	67
		1919-1921	1936
United States of America*	—	59	64
	1910-1912	1920-1922	1937
England and Wales	55	60	64
	1911-1915	1921-1925	1931-1935
Sweden	59	63	65
	1910-1911	1924-1926	1932-1934
Germany.	51	59	63
	1908-1913	1920-1923	1928-1933
France.	52	56	59
	1910-1912	1921-1922	1930-1932
Italy	47	51	56
	1896-1897	1926-1927	
U.S.S.R.	33	47 ^b	—
	1900-1905	1925-1928	
Bulgaria	42	47	—
		1921-1925	1926-1930
Japan	—	43	47
	1911		1931
India	23	—	27

* White population only. 1919-1921: death registration area of 1920. ^b U.S.S.R. in Europe only.

In every case, the increased expectation of life is evident. But the most striking feature of the table is the wide differences in the figures for different countries; and it is precisely in those countries — such as India, Japan and the Union of Soviet Socialist Republics — which are at present growing in numbers rapidly that the greatest opportunities for reduced mortality still exist.

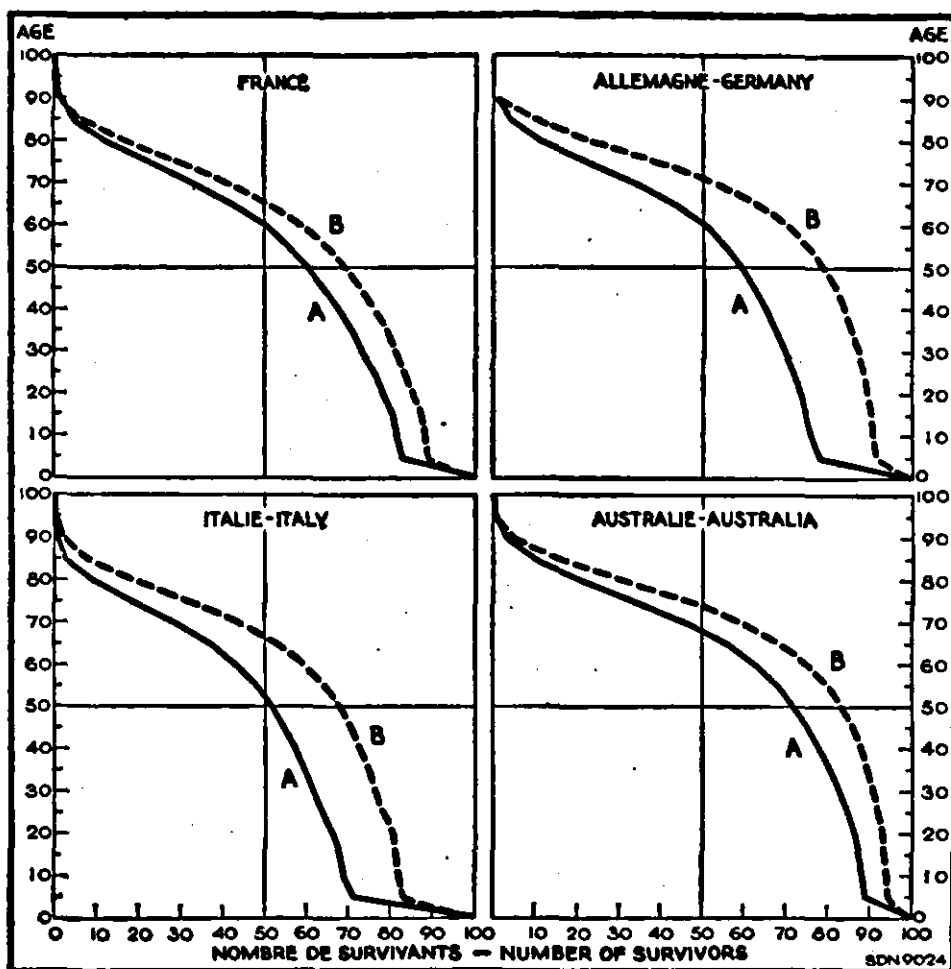
Reduced mortality in the past has had most important effects upon the size of present populations; in many countries, the size of the present working population has been greatly swollen not only by the high level of births which ruled at the beginning of the twentieth century, but also by the marked reduction in mortality which has enabled a larger proportion of these infants to survive to working-age.

¹ Figures from the *Statistical Year-Book of the League of Nations, 1938/39.*

*Number of Survivors to Different Ages from 100 Births.**

A Mortality at pre-war rates.

B Mortality at recent rates.



* Germany and Australia: females only. Mortality at rates ruling in the following years: France, A 1908-1913, B 1928-1933; Germany, A 1901-1910, B 1932-1934; Italy, A 1899-1902, B 1930-1932; Australia, A 1901-1910, B 1932-1934. Cf. *The Statistical Year-Book of the League of Nations, 1938/39*, Table 10.

As can be seen from the above graph, the number of persons surviving from 100 births to the more advanced ages has greatly increased as a result of reduced mortality since the beginning of the twentieth century. This increased chance of survival has been largely due to reduced rates of infant mortality; for the graph shows in every case a greatly increased chance of survival between birth and the attainment of 5 years of age.

THE BALANCE OF FERTILITY AND MORTALITY

In discussing the age-distribution of populations, it was apparent that temporarily abnormal age-distributions may obscure the true position in such a way that movements of birth rates and death rates misrepresent the real changes in fertility and mortality. Two convenient measures — the gross and the net reproduction rates¹ — can be used to show the true force of fertility and the true balance between fertility and mortality. The gross reproduction rate measures the rate at which a population would reproduce itself in the course of each generation, if fertility remained unchanged at the current level and if no potential mothers died before the end of the reproductive period. Thus a gross reproduction rate of 1.20 means that a population would, in these conditions, increase by 20% in each generation.

The net reproduction rate makes allowance for mortality, and measures the rate at which a population would reproduce itself in each generation if both fertility and mortality remained unchanged at current rates. Thus a net reproduction rate of 0.90 means that the population at current rates of fertility and mortality is reproducing only 90% of itself in each generation.

The table on page 153 gives figures of the gross and net reproduction rates for various countries at various times. The figures for gross reproduction rates show a universal fall, which, in many cases, has been very marked. Fertility had fallen so low by 1933 in some countries, such as Germany, England and Wales and Sweden, that, even in the absence of any mortality before the end of the reproductive period, these populations were not reproducing themselves. In all cases, the net reproduction rate has also fallen; and this shows that the reduction in mortality has not been sufficient to counteract the reduction in fertility.

The net reproduction rates for Japan and the Union of Soviet Socialist Republics are still very high; and these populations in the long run would increase at a rate of more than 50% in each generation if current rates of mortality and fertility continued. In both countries, however, fertility shows a marked decline. In the case of Japan, the decline in mortality has, in large measure, offset this fall in fertility, so that the net reproduction rate declined only moderately between 1925 and 1930; and, since the expectation of life in Japan is relatively low, there is room for still further considerable reductions in mortality to offset any future decline in fertility. In some

¹ Cf. R. R. KUCZYNSKI: *The Measurement of Population Growth*.

Gross and Net Reproduction Rates.

G = Gross reproduction rate.

N = Net reproduction rate.

U.S.S.R. (Europe only) . . .	{ G N	1896-1897	1926-1927	1929	
		—	2.72 ^a	2.40 ^a	
Japan	{ G N		1925	1930	
			2.60	2.37	
Bulgaria	{ G N	1900-1905	1921-1926		1933-1936
		3.24 ^a	2.50		1.67
Italy	{ G N		1921-1922	1931	1935-1937
			2.00 ^a	1.57	1.43
Poland	{ G N		1921	1927-1928	1934
			2.24 ^a	1.95	1.50
United States of America (whites only)	{ G N		1919-1920	1933	1935
			1.38 ^c	1.04	1.06
Australia	{ G N		1920-1922	1932-1934	1937
			1.52	1.05	1.08
Germany	{ G N	1900-1910	1925	1933	1936
		2.13 ^a	1.13 ^b	0.80	1.06
France	{ G N	1898-1903	1920-1923		1936
		1.39 ^a	1.23		1.01
England and Wales . . .	{ G N		1920-1922	1933	1937
			1.35	0.85	0.88
Sweden	{ G N	1900-1910	1921-1925	1931-1934	1936
		1.88 ^a	1.24	0.85	0.84
		1.43 ^a	1.06	0.76	0.76

SOURCES:

^a KUCZYNSKI: "The Decrease of Fertility", *Economica*, May 1935.

^b KUCZYNSKI: *Balance of Births and Deaths*.

^c KUCZYNSKI: *Encyclopædia of Social Sciences*.

Other figures are from the *Statistical Year-Book of the League of Nations*.

countries of Europe, such as Bulgaria, Italy and Poland, the net reproduction rate is still higher than 1.00, which shows that, in these countries, fertility is still stronger than mortality. But in all these three countries, fertility is declining more rapidly than mortality. In many countries, such as the United States, Australia, Germany, France, England and Wales and Sweden, fertility has declined to such a level that the populations of these countries are no longer fully reproducing themselves; and, since in all of these countries mortality is already low, it is improbable that a reduction in mortality could fully redress the balance, except perhaps in the United States and Australia. Indeed, in England and Wales and in Sweden, fertility has fallen so low that, even with a complete elimination of all mortality before the end of the reproductive period, the populations would in the long run fall at a rate of 12%-16% in each generation, and, in actual fact, each generation is only reproducing about three-quarters of itself.

It is of some interest to compare the movements of the rates of reproduction in Germany and France. In both countries, net reproduction rates are now about 0.90, and show that, at current fertility and mortality, the populations would in the long run diminish at a rate of between 7% and 12% in each generation. Yet, in spite of this, there is still a considerable excess of births over deaths in Germany, while the population of France has actually started to decline. The reason for this discrepancy is to be seen in the past history of population changes in the two countries. Fertility was already low in France by the beginning of the present century and has since declined moderately. On the other hand, fertility was high in Germany at the beginning of the century, but has declined rapidly since then. Because of the high number of births which occurred in Germany some thirty or forty years ago, the German population now contains a larger percentage of persons of reproductive age, so that, for the time being, the birth rate is abnormally high and the death rate abnormally low.

The table on page 153 shows that, in the United States, Australia, England and Wales, and, to a marked extent, in Germany, there has been some increase in fertility since 1933, one of the worst years of the great depression. In England and Wales and in the United States, this recovery of fertility has been very small; and probably it merely reflects the fact that, in the worst years of the depression, certain persons postponed their marriages and certain married couples postponed the production of another child. If this is so, the change in trend is likely to be only temporary. In Germany, however, the change

has been marked; and although the same temporary forces may have depressed German fertility during 1933 more than fertility in the United States or in England and Wales, a large part of the recovery in fertility must be ascribed to the population policy which Germany has adopted in recent years and which will be described later.

In the absence of strong counteracting measures, the general downward trend of fertility may be expected to continue still farther. For there is evidence that fertility is generally lower in the towns than in the country and among the educated and the relatively rich than among the poor and the uneducated. It is therefore probable that, in many regions, increasing urbanisation and industrialisation, together with rising standards of living and of education will cause fertility to fall still farther.

It is probable, then, that in Western and Northern Europe, Northern America and Australasia populations will sooner or later begin to fall. At the same time, the age-composition of these populations will change. On the one hand, the proportion of old persons will grow; on the other hand, the proportion of children, and subsequently of persons of working-age, will decline. In such countries as Italy, Poland and Bulgaria, population growth will continue for some time longer; but if fertility continues to fall, a subsequent decline of population is not improbable. In Japan and the Union of Soviet Socialist Republics, on the other hand, the population growth is likely to continue for many years at a rapid rate.

ECONOMIC EFFECTS OF POPULATION CHANGES

For a discussion of the economic effects of population changes, it is useful to distinguish between three closely related questions. First, a country may be over- or underpopulated; and, for this reason, a change in the size of a population may help to raise the standard of living. Secondly, there are certain economic problems which are affected mainly by the rate of growth of a population; thus a change from a rapidly growing to a declining population will have certain economic effects quite apart from the question whether the country is over- or underpopulated. Thirdly, changes in the age composition of a population will also have important economic consequences.

The change from a rising to a declining population, which is likely to occur in many countries, will have important economic effects. In past decades, in Western and Northern Europe and in Northern America, a great deal of capital construction has been necessitated simply by the growth of popula-

tion. The demand for houses, for example, is very largely dependent upon the number of new households which are being set up, and the demand for schools is primarily dependent upon the number of new children of school age. Even the demand for ordinary industrial capital equipment may be diminished when the number of new consumers of the products of industry ceases to grow. For this reason, in rich communities in which people are likely to continue to save a relatively high proportion of their incomes, the incentive to borrow savings for capital development may be depressed below the funds which people wish to save, so that unemployment and trade depression result from the reduction of activity in the construction industries. To offset such a possible result, it may become increasingly important either to stimulate activity in the capital goods industries by lowering interest rates or by increased public investment or else to stimulate expenditure on consumption goods in order to counterbalance the reduced demand for new capital equipment.¹

But there is a second reason why the change in population trend may lead to unemployment. When population is growing rapidly, the demand for almost all goods and services is likely to grow unless income per head is tending to diminish. If, for one reason or another, a particular commodity is overproduced, the consequent maladjustment may be rectified simply by refraining from installing more productive plant and from employing more labour until the demand has expanded again with the growth in the number of consumers. But if a particular commodity is overproduced in the absence of an expanding population, it may become necessary actually to shift the excessive capital and the excessive labour into other industries. It is always much easier to guide new labour or new capital into one occupation in preference to another than it is to shift existing labour and capital from one occupation for which they are already specialised into another. For this reason, economic adjustments will be more difficult with a stationary or a declining population than with an expanding population; and unless effective steps are taken to increase their adaptability, more labour and capital than before may be unemployed as a result of the overproduction of particular commodities.²

There are some commodities, such as the basic foodstuffs, the demand for which — in relatively rich communities at

¹ Cf., J. M. KEYNES: "Some Economic Consequences of a Declining Population", *Eugenics Review*, April 1937.

² Cf., HENDERSON: "Economic Consequences and Problems", *Sociological Review*, July 1937; ROBBINS: "Notes on Some Probable Consequences of the Advent of a Stationary Population in Great Britain", *Economica*, April 1929.

least — depends primarily upon the size of the population. With a cessation of population growth, the demand for agricultural products will cease to grow or at least will grow at a very much slower rate. If agricultural inventions and improvements in agricultural technique continue at their present rate, this may mean that agriculturists will be threatened with serious overproduction and a serious excess of productive capacity, which can no longer be remedied simply by waiting for a growth of population to bring forth a new and increased demand. The peculiar difficulties experienced by agriculture in recent years may already perhaps be partly explained by the reduced rate of population growth. This agricultural maladjustment will probably have important effects upon international economic relations. During the nineteenth century, undeveloped overseas areas were opened up by means of the overseas investment of capital by the developed industrialised States. These imports of capital were utilised by the undeveloped countries for the production of more foodstuffs, which in turn were consumed by the growing populations of the industrialised States. This growing demand for their products in turn enabled the overseas areas to pay the interest and sinking fund on their debts. In future, this simple relation between the undeveloped overseas areas and the industrialised countries of Europe can no longer exist, as the basis of a growing population will be lacking.¹

The demand for capital equipment depends largely upon the rate of growth of population, and the demand for basic foodstuffs upon the size of the population. But there is a third class of commodities — namely, luxuries or semi-luxuries — the demand for which is most affected by the standard of living of the population. For various reasons, there is likely to be a continued rise in the standard of living in the countries which are threatened with a decline of population, provided that effective measures can be taken to offset the danger of growing unemployment and that armament expenditure does not absorb the whole of the increase in national income per head. The present trends of rising standards due to improved technique and increasing supplies of capital equipment are likely to continue. Moreover, a fall in the population will enable each worker to be equipped with a greater amount of the existing resources of capital and of raw materials, and this may raise the productivity of labour. This increasing scarcity of labour in relation to capital equipment and to natural resources may lead to a rise in wages at the expense of incomes from

¹ Cf., HENDERSON, *op. cit.*

property and so to a more equal distribution of income. For these reasons, the demand for semi-luxuries is likely to rise or, at least, to fall less rapidly than the demand for other commodities when population declines.¹

At the same time, the changing age-composition of the populations will be exerting an important economic influence. In England and Wales, for example, it is estimated² that the proportion of people in the earning ages (15-65) will continue to increase for some years. This in itself should allow for an increase in real income per head, since there will be a smaller proportion of idle dependents to productive workers. But this advantage will be gained only if the difficulties discussed above do not lead to greater waste of productive labour through increased unemployment. The most striking future change in the age-composition of most of the populations which are now threatened with a decline, is likely to be the increase in the number of old persons and the decrease in the number of children. To some extent, the increased burden of support for the old may be offset by a reduced burden of support for education. But there is likely to be a substantial increase in the net social burden. For the overhead costs of education will not fall *pari passu* with the number of children seeking education, and educational facilities are likely to be still further improved and extended; while the need for old-age pensions will rise at least to the full extent of the increase in the number of old persons. At the same time, it is probable that, as part of a population policy designed to counteract the fall in fertility, new allowances will be paid in one form or another to reduce the cost to the individual parents of producing and bringing up a family.

This increased burden of support for dependent persons may lead to some reduction in the proportion of the national income which is saved. For the increased expenditure on old age pensions is likely to be financed by taxes or contributions levied from persons of working age or from the rich; and these persons may cut down their savings in order to pay the contributions which will finance the consumption expenditure of the old. This may in part offset the tendency which was noted above for the need for new capital equipment to fall more quickly than the supply of savings, as a population growth gives place to

¹ It is difficult in some cases to say how the demand for certain particular commodities will be affected. The demand for durable consumption goods, such as motor-cars, may, like capital goods, be adversely affected by the cessation of population growth, but will be favourably affected by a rising standard of living. It is difficult to say which influence will be the more effective.

² Cf., Dr. ENID CHARLES: *The Effect of Present Trends in Fertility and Mortality upon the Future Population of England and Wales and upon its Age-composition.*

a decline of numbers. These changes must not, however, be exaggerated. For, in assessing the importance of the economic effects of the ageing of a population, it must be remembered that many countries have already experienced a very marked shift in the age-composition of their populations without experiencing any catastrophic economic effects.¹

There is still a number of countries, such as Japan, India, Italy, Poland and Bulgaria, in which the population will continue to grow at a relatively rapid rate for a considerable time. These countries will avoid the particular economic difficulties which have just been discussed. There will, for example, be a continual demand for new capital equipment to keep pace with the growing population; and the proportion of old persons in retirement does not threaten to become excessive.

On the other hand, a rapid increase of population brings with it its own peculiar economic problems, the most important of which is the threat of possible overpopulation and a consequent decline in the standard of living. It is extremely difficult to judge whether a particular country is suffering from overpopulation or from underpopulation. Moreover, the ability of a country to sustain an increase in population depends, not only upon the wealth of its natural resources, but also upon its capital equipment and upon the technical ability of its producers. For this reason, a relatively undeveloped country may give signs of a temporary rural overpopulation in spite of rich natural resources, if the rate of growth of its population is more rapid than the growth of its capital equipment and the development of its industrial and agricultural technique. Roumania, for example, may be in this position.

A large number of the countries with rapidly increasing populations are agricultural and lack capital. Such countries may be faced with serious economic problems as their population growth leads to rural overpopulation. In present conditions of restricted foreign markets, it will be difficult for them to expand their exports of agricultural products. Even if they possess raw materials, lack of capital may prevent them from exploiting these resources and from industrialising; for their own savings will probably be meagre and it will be difficult for them to borrow from abroad so long as exchange controls, political uncertainties and the difficulties which the debtor countries find in generating an export surplus to finance the service of their debts restrict the willingness of investors to make foreign loans. Moreover, as will appear in a later section, emigration from such countries is at present seriously hampered.

¹ Some of the changes which have already occurred in the age-composition of different populations are illustrated in the graph on page 148.

There are certain cases in which overpopulation is already apparent. China, India and Japan almost certainly suffer from severe population pressure.¹ In India, for example, birth rates and death rates are both high. There are small reserves, so that crop failures are followed by particularly high death rates due to malnutrition, epidemics and famine and by lower birth rates due to the enfeeblement of the population. The expectation of life is very low. There is a high density of population, and agricultural holdings are, in many cases, uneconomically small. All these features suggest a population which tends to expand up to the limits set by the available resources, and whose further expansion is only checked by the high mortality of famine years. The fact that, in spite of this pressure of population on the means of subsistence, there is a continuing growth of numbers may be ascribed to the fact that new resources have been continually opened up in India for the extension of agriculture by means of irrigation and similar schemes.

On the other hand, there is a number of relatively undeveloped countries in which population density is low in spite of a comparatively good climate and rich natural resources. Certain regions of North and of South America and of Australasia fall into this category. In South America, there is still a high rate of natural increase of population; but in the United States, Australia and New Zealand, the populations are not fully reproducing themselves at current rates of mortality and fertility. There is, therefore, a certain disharmony in the present trends of population growth. For many of the countries which show signs of some degree of population pressure, such as Japan, India, Italy, Poland and Bulgaria, continue to increase rapidly or at least to show no signs of an approaching decline in numbers; whereas the populations of many relatively sparsely populated areas are likely soon to decline.

POPULATION POLICIES

A number of countries have already adopted specific policies to meet the population problems which have been examined in the foregoing sections. Some countries which are threatened with a decline of population have already taken measures to encourage births.² In France, family allowances have for long been paid to workers according to the number of their children;

¹ Cf., CARR-SAUNDERS: *World Population*, Chapters XVIII and XIX; PENROSE: *Population Theories and their Application, with Special Reference to Japan*, Chapter V; WATTAL: *The Population Problem in India*, Chapter VII.

² Cf., GLASS: *The Struggle for Population*, *passim*.

and one of the objectives of this system is to promote births; but it has been estimated that, on an average, the allowances are sufficient to cover at most 25% of the cost of maintaining a child. A number of other countries, including Belgium, Chile, Italy and New Zealand, now have schemes of family allowances.¹ In July 1939, further measures, including the payment of bonuses on the birth of each child and additional taxation on bachelors, were undertaken in France to stimulate births.

A policy of assistance of this kind for the support of the family may help to counteract a threatened decline in the population in two ways. Births may be directly encouraged when the parents know that part at least of the cost of support of the children will be met by the payment of family allowances. But the receipt of family allowances by raising the standard of living of large families with small resources may also so improve nutrition and conditions of life generally that mortality will be reduced. This possibility must not be exaggerated. For it is precisely in those countries in which a population decline is imminent that mortality is already comparatively low; and, in some cases, such as England and Wales and Sweden, fertility has now fallen so low that the most widespread reduction in mortality could not possibly enable the population fully to reproduce itself again. Nevertheless, there is evidence that, even in such countries, an improvement in nutrition and in the general conditions of life of the poorer classes would still appreciably reduce mortality and so make some contribution to the solution of the problem.²

Germany has adopted a more comprehensive policy for the promotion of births than any other country. This policy includes favours to the large families, such as income-tax allowances and inheritance-tax favours, rent allowances, preferences in public employment, and safeguards against discharge from employment; privileges are extended to mothers with young children in railway trains; a system of sponsoring third and subsequent children has been adopted by several large towns. At the same time, there has been a vigorous campaign against abortion; and, since 1933, an Act has provided for the provision of marriage loans, one quarter of which is remitted on the birth of each child. As the figures for the birth rate (*cf.* page 144 above) and for reproduction rates (*cf.* page 153 above) show, fertility has risen considerably since the initiation of this policy in 1933. This rise in fertility must be largely

¹ *Cf.*, *International Labour Office Year-Book, 1937/38*, pages 369-375.

² R. M. TRIMMUS, in "Poverty and Population", shows this by means of a comparison of mortality in the poorer areas of England and Wales with mortality in the prosperous areas.

ascribed to the population policy; and it is generally agreed that the provision of marriage loans and the campaign against abortion have had the greatest effect.

Italy also has adopted a policy designed to stimulate births, even though the country may already be overpopulated, and, in any case, still enjoys a net reproduction rate which is greater than 1.00. Bachelors are submitted to a special tax; and bachelors and childless couples pay higher rates of income tax. Preference for employment is given to married men with children; and certain taxes are reduced or abolished for large families. Since 1934, a system of family allowances for industrial workers has been introduced, partly as a means of stimulating births. Action has also been taken to prevent the practice of abortion and to restrict the use of contraceptives. These measures do not seem to have prevented a fall in the birth rate; and the net reproduction rate in Italy has fallen and is now only just greater than 1.00.

In the Scandinavian countries also, certain measures have been taken to counteract the imminent decline in population.¹ These measures do not include a campaign against abortion and birth-control, as in the case of Germany and Italy, but are mainly concerned with the granting of free public services for children or expectant mothers. In Sweden, the measures taken include protecting the employment of mothers in public services, cheap hospital services for maternity, grants to cover the cost of childbirth, marriage loans, increased tax deductions for large families and the use of housing subsidies to grant rent rebates to large families. In Denmark, as in Sweden, a Royal Commission on Population Questions was set up in 1935; and, as a consequence of a report of this Commission, a law has been passed to grant rent rebates to large families. In Norway, mothers in need are entitled to help from the communes during pregnancy and child-birth; the famous "Oslo" breakfasts are provided free of charge to school-children; and a Committee has now just reported in favour of a scheme of family allowances.

On the other hand, no country has, up to the present, undertaken measures expressly designed to control excessive births. But there is some evidence that methods of family limitation are becoming known in Japan and, at a much slower pace, in India.²

¹ MYRDAL: "Population Problems and Policies", *Annals of the American Academy of Political and Social Science*, May 1938; GLASS: "Population Policies in Scandinavia", *Eugenics Review*, July 1938.

² Cf., WATTAL: *The Population Problem in India*, Chapter V; PENROSE: *Population Theories and their Application, with Special Reference to Japan*, Chapter IV; ISHII: *Population Pressure and Economic Life in Japan*, Chapter XI.

MIGRATION ¹

In the nineteenth century, immigration from Europe to North and South America, to Australasia and to South Africa played an important rôle in easing population pressure in Europe and in developing these previously undeveloped areas. There has also been some movement of Japanese into the outlying parts of the Japanese Empire and to some countries of South America: some movement of Chinese to other parts of Asia, and in particular to Malaya and the Netherlands Indies: and some movement of Indians to the West Indies, to South and East Africa and, more recently, to Ceylon and Malaya; but these movements have been insignificant in comparison with the populations of the countries of emigration, although they have sometimes been of considerable importance to the countries or colonies of immigration.

Within Europe there have been considerable movements of labour, either seasonally or for permanent settlement, from South and East Europe to Western Europe, and, in particular, from Poland and Italy into Germany and France. As the following figures show, France constitutes in this way an important country of immigration. These movements of labour within Europe have been greatly diminished since 1929 as a result of the great depression; but, as the figures show, there

*European Continental Migration.** (Gross figures.)

	Emigration of nationals			Immigration of aliens		
	Poland	Italy	Czecho-Slovakia	Germany	France	Belgium
1929	178,132	88,054	35,063	125,388	179,321	45,006
1930	171,853	220,985	39,972	109,421	221,619	43,217
1931	64,235	125,079	26,434	50,141	102,267	22,018
1932	11,772	58,545	17,410	9,800	69,492	14,881
1933	18,358	60,736	12,220	3,509 ^a	74,635	10,024
1934	21,761	42,296	9,640	19,095 ^a	71,538	8,157
1935	19,189	30,579	7,981	29,310 ^a	56,506	7,920
1936	29,770	21,882	8,717	...	40,990	9,650
1937	78,627	29,670	17,853	...	67,905	15,609
1938	107,801	51,761	3,960 ^b	...	46,090	8,303

^a Figures for year beginning April 1st of current year and ending March 31st of the following year. ^b Excluding territories incorporated in neighbour States.

¹ Cf., CARR-SAUNDERS: *World Population*, Chapters IV, XII-XV and XXI; National Bureau of Economic Research: *International Migrations*, Vols. I and II; Louis GINSBERG: *Population Movements*; various reports by the International Labour Office.

^a Figures from the International Labour Office *Year-Book of Labour Statistics*.

has been some revival of these movements with the recovery in recent years.

Overseas migration from Europe has, however, been much more important than any other form of migration. It reached its height in the years at the end of the nineteenth and beginning of the twentieth century, and then fell to a considerably lower figure during and after the great war.

Number of Emigrants from Europe. ¹ (Annual average.)	1906-1910 1,389,000	1921-1924 775,000
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Since the onset of the great depression in 1929, emigration from Europe has again diminished, until, in the worst years of the depression, there was actually a net return of emigrants to Europe. This reduction in migration since 1929 has been due both to the fact that trade depression and unemployment in the countries of immigration have greatly reduced the openings for new immigrants, and also to the fact that in many cases administrative measures have been taken to increase the restrictions on immigration. With recovery from the depression, there has been some revival of emigration. These recent changes are illustrated by the following table.

*Net Intercontinental Emigration (—) or Immigration (+)
in Certain Countries.²*

I. Nationals (000's.).

	1928	1932	1937	1938
Germany ^a	— 11.5	+ 29.4	+ 30.9	+ 24.2
Spain	— 11.1	+ 38.7	...	...
United Kingdom	— 77.7	+ 48.6	+ 10.9	+ 6.5
Ireland	— 22.5	+ 3.2	+ 0.0	— 0.5
Italy	— 21.0	+ 8.9	— 15.1	— 15.5
Poland	— 58.4	— 3.8	— 22.0	— 19.6
Czecho-Slovakia	— 12.4	+ 0.8	— 5.1	— 4.8
Yugoslavia	— 15.7	+ 3.8	— 1.4	— 1.8

II. Aliens (000's.).

Argentina ^b	+ 74.8	— 11.6	+ 27.3	+ 25.0
Australia ^c	+ 28.7	— 4.4	+ 5.9	+ 10.0
Brazil ^{b d}	+ 34.8	+ 9.2	+ 16.6	+ 7.9
United States of America	+ 101.1	— 47.2	+ 25.0	+ 42.4
Uruguay ^{b c}	+ 10.2	+ 0.7	+ 3.0	+ 4.4

^a Immigration: Passengers inwards.
^b Passenger movement.

^c Including nationals.
^d Including continental migration.

¹ Figures from Vol. I of *International Migrations*, published by the National Bureau of Economic Research, New York.

² Figures from the International Labour Office *Year-Book of Labour Statistics*.

The serious reduction in the volume of migration since the beginning of the century is due to the severe restrictions which many countries have imposed upon immigration. During the last years of the nineteenth and the first years of the twentieth century, the United States of America and the British Dominions, which with the countries of South America provided the greatest opportunities for immigration, closed their doors to Chinese and Japanese immigrants, and indeed practically to all Asiatic immigrants.

Restriction of immigration has been applied by the United States and the British Dominions to European immigrants as well. The Quota Acts of the United States, passed in 1921 and 1924, greatly restricted immigration. While immigration from countries to which the quota is applied had averaged over 800,000 per annum in the years 1900-1914, total annual immigration from these countries was fixed at a maximum of 357,803 as a result of the Act of 1921 and 153,774 as a result of the Act of 1924. But these Acts discriminated severely in favour of migrants from the United Kingdom and from Northern and Western Europe as opposed to those coming from Eastern and Southern Europe. For example, the Italian quota was fixed at 3,845 and the Polish quota at 6,524, which figures may be compared with an annual average immigration of some 200,000 Italians into the United States during the years 1900-1914 and with an immigration of some 95,000 Poles into the United States in 1921. Immigration into Canada, Australia, New Zealand and the Union of South Africa is also strictly controlled; and these controls have been used to discriminate, first, in favour of British immigrants and, secondly, in many cases in favour of immigrants from the north and west as opposed to the east and south of Europe. The countries of Central and Southern America have restricted immigration by the strict control of visas; and a serious limitation on European immigration is imposed by a clause of the Federal Constitution of Brazil, which limits immigration for each nationality to 2% of the number of immigrants of that nationality who have settled in Brazil during the last fifty years.

In short, practically all important countries of immigration except some countries of South America exclude Asiatics; and many important countries of immigration discriminate severely in favour of migrants from Western and Northern Europe as opposed to migrants from Eastern and Southern Europe. But it is precisely in Northern and Western Europe that a population decline is imminent; and it is in Southern and Eastern Europe and in certain countries of Asia that there

is most evidence of overpopulation and the likelihood of a continuation of rapid population growth.

While, in the main, migration has been subject to Government restrictions, certain measures have been taken to encourage suitable movements. The Japanese Government has encouraged and assisted financially the emigration of Japanese both to other parts of the Japanese Empire and also to foreign countries. In particular, the British Government by means of the Empire Settlement Act, which was passed in 1922 and was renewed in 1937 has assisted emigration from the United Kingdom to the British Dominions. Moreover, a number of bilateral treaties have been signed for the regulation of the collective migration of workers, whether for seasonal work or for permanent settlement, between the countries of emigration and of immigration. France has negotiated a number of such treaties, which are designed to regulate the technical measures necessary for migration, to protect the immigrants from exploitation and to prevent the labour market in the country of immigration from being flooded. Many such treaties exist as a means of regulating migration within Europe; but there are also a few which affect migration from Europe to overseas countries. For example, Netherlands-Argentine, Switzerland-Argentine and Denmark-Argentine agreements signed in 1937 are designed to facilitate and to regulate European migration into the Argentine.

The International Labour Organisation has encouraged the formation of such agreements; and, with the recent recovery in migration, efforts have been made to encourage international co-operation to regulate conditions of migration to the countries of South America. For this purpose, in February and March 1938, a Conference of Experts was held to discuss technical and financial co-operation between nations to regulate the conditions of migration for settlement in Latin America; and this conference recommended the institution of a Permanent International Committee on Migration for Settlement.¹

In spite of these developments, it is doubtful whether migration can ever constitute more than a partial cure for maladjustments of population. Even in the absence of any unnecessary restrictions on migration there is a definite limit to the annual number of migrants which the countries of immigration could absorb in view of the cultural difficulties of assimilation and the economic difficulties of adjusting the country's economy to a rapid increase in the supply of labour. Moreover,

¹ Cf., International Labour Office: "Studies and Reports", Series O (Migration), No. 7, "Technical and Financial International Co-operation with regard to Migration for Settlement".

migration is often an expensive method of solution of the problem for the overpopulated countries. For it means that the overpopulated countries produce and maintain potential workers during their unproductive and expensive days of childhood and education, in order to send them to some other country when they reach their productive manhood.

Apart from the freer movement of populations across national frontiers, a number of countries have urged that a greater freedom of movement of capital and of international trade would help to relieve the pressure of population. For such a development might reduce the scarcity of capital resources in overpopulated areas; and it would also enable such areas to concentrate on the production of commodities for which a large supply of labour gave the greatest advantages. Both measures might thus help to ease the problem by means of the industrialisation of overpopulated countries.

Chapter VII.

INTERNATIONAL TRADE AND THE FOREIGN EXCHANGES

WORLD TRADE DURING RECESSION AND RECOVERY ¹

The recession in business activity in many important industrialised countries from the middle of 1937 to the middle of 1938, and the subsequent recovery from this recession, had a marked effect upon the volume and direction of world trade. As the graph on page 169 shows, the quantum of world trade had by 1937 recovered practically to the 1929 level; but the fall in demand for goods and services between the middle of 1937 and the middle of 1938 caused a decline in the price of goods entering into world trade and also in the total value and quantum ² of such trade. The subsequent recovery in demand caused the value of world trade to rise rather more than seasonally during the second half of 1938; but in the first quarter of 1939 there was again some fall in the price of traded goods.

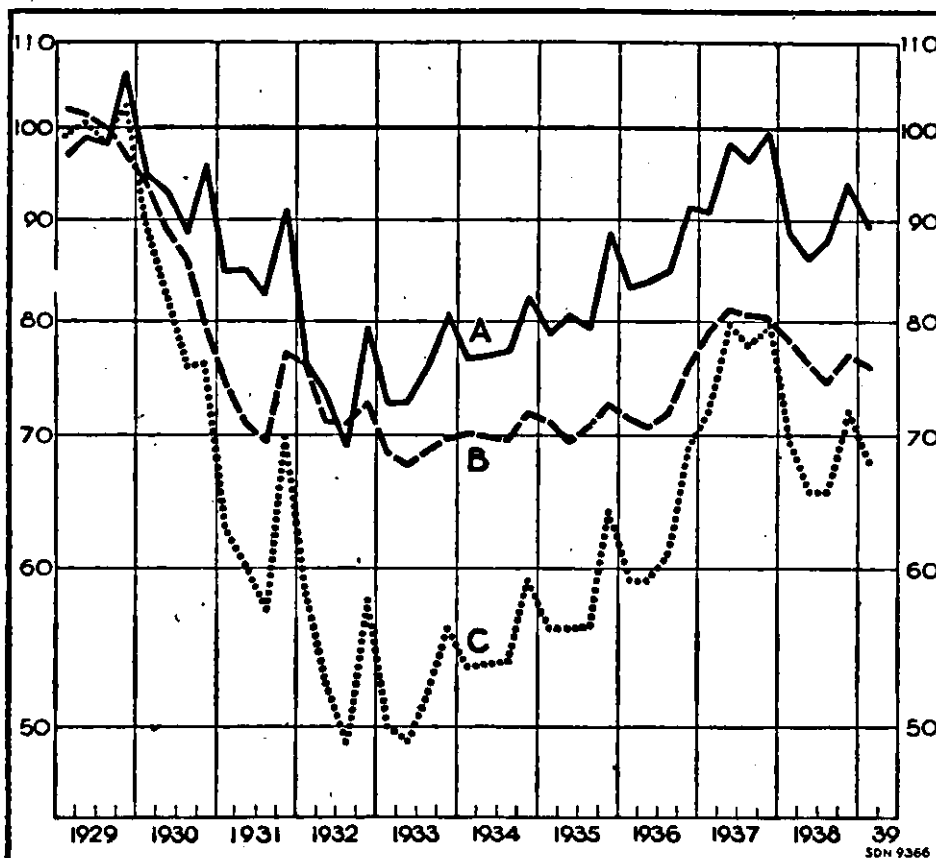
These fluctuations followed very closely the changes of business activity in the United States, where the recession from mid-1937 to mid-1938 was followed by a rapid recovery in the second half of 1938 and by a renewed hesitation in activity in the first quarter of 1939. These similarities between the fluctuations in demand in the United States and in the value of world trade are readily explained by the great importance which the American demand exercises in world markets and, in particular, in the markets for raw materials. The imports of the United States fell by 35% between 1937 and 1938 — a greater percentage fall than in the case of any other country except Mexico. This fall in American imports accounted directly for nearly a third of the total decline in world imports and for about half of the total decline of trade in raw materials between 1937 and 1938; and, if allowance could be made for the indirect depressing effects of the American recession on the demand of other countries for imports, the influence of the American economic decline and recovery upon world trade would be correspondingly greater.

¹ Cf. *Review of World Trade, 1938* (League of Nations).

² The quantum of world trade is calculated from the value of world trade by eliminating changes due to alterations in the unit price of traded commodities.

World Trade.

A Quantum of world trade. B Sterling price of traded commodities.
 C Sterling value of world trade.
 (1929 = 100.)



These changes have had their usual effect upon the relative prices of primary products and of manufactured goods. During a period of declining demand, the prices of primary products normally fall rapidly, while their production is relatively inflexible; and the prices of manufactured goods are usually well maintained, while their production falls considerably. In fact, the prices of primary products and of raw materials fell relatively to the prices of manufactured exports from mid-1937 to mid-1938, and subsequently rose again with the recovery in world demand. As is clear from the graph on page 170, this change in price relationships during the recession moved the terms of exchange between imports and exports to the disadvantage of the countries, such as the Netherlands Indies,

which rely mainly upon the export of primary products, and to the advantage of industrial countries such as the United Kingdom and Germany; and by the end of 1938 this change in the terms of trade had been only partly reversed.

Export Prices as a Percentage of Import Prices.

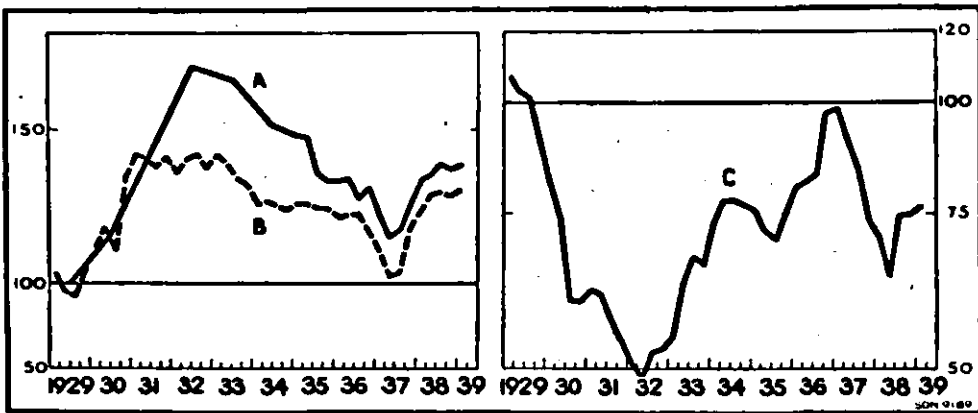
(1929 = 100.)

A Germany.

C Netherlands Indies.

B United Kingdom.

(Logarithmic scale.)



NOTE. — *Germany and United Kingdom*: Prices of manufactured goods exported as a percentage of those of raw materials imported. *Netherlands Indies*: Prices of all goods exported as a percentage of those of all goods imported.

REARMAMENT AND WORLD TRADE ¹

Growing expenditure upon rearmament in many countries has stimulated the general level of demand for goods, including imported commodities; and in this way it has helped to sustain the volume of world trade.

Wars, fears of war and measures of military and economic defence have, moreover, greatly influenced particular channels of trade. The recorded trade in actual arms and munitions of war, although it increased by 74% between 1932 and 1937, remains unimportant; and in 1937 it did not represent as much as ½% of the recorded total of world trade. But the demand for materials for the production of armaments and the demand for essential foodstuffs and materials for storage purposes have had a considerable influence on the movements of world trade.

¹ Cf. *Review of World Trade, 1938* (League of Nations).

Largely as a result of such factors, Germany and Austria combined,¹ alone of all industrial countries, increased the quantum of their imports between 1937 and 1938. In this period the quantum of their imports rose between 7 and 8%, which represented an increase about twice as great as the increase in German industrial production. It is probable that a considerable part of the increased demand for imports was for storage purposes. Thus, in spite of abundant crops, the imports of cereals, which had risen from 353,000 to 3,870,000 tons between 1936 and 1937, rose further to 3,910,000 tons in 1938. The quantity of oil seeds imported rose by 14%, of copper by 35%, of raw iron (including scrap) by 131%, of petrol by 28% and of gas oil by 23% between 1937 and 1938.

In Japan, the gold value of total imports fell by as much as 30% between 1937 and 1938; and, in particular, there were heavy declines in imports of manufactured articles for consumption purposes and of raw cotton and wool. But at the same time imports necessary for the prosecution of the war against China rose considerably in value, as the following figures suggest:

Certain Japanese Imports.

	Yen (000,000's).		
	1936	1937	1938
Unspecified machinery and parts of machinery	65	123	212
Unspecified oils, fats, waxes and manufactures thereof (including mineral oils) .	184	280	320
Ores and metals	375	901	662

In the United Kingdom, the Government spent £8½ million during the fiscal year 1938/39 for the storage of foodstuffs, fertilisers and petroleum under the Essential Commodities Reserves Act; but this expenditure represented less than 2% of total imports under these heads for the year 1938. The increase in the demand for certain metals required for the production of armaments or for the formation of reserves in case of war has probably been more important, as the following figures show:

United Kingdom.

	Cwts. (000's).		
	1936	1937	1938
General imports of:			
Aluminium and alloys.	434	631	925
Nickel	67	213	134

¹ Exclusive of the trade between these two countries.

Many other examples might be given of countries in which rearmament or the storage of essential materials and durable foodstuffs had substantially stimulated the import for certain commodities. The importance of this factor is illustrated by the movements of commodity prices in world trade during 1938. Between 1937 and 1938 there was a general tendency of prices to fall; but there were several commodities whose prices rose. Prominent among these were materials such as iron, steel, cement and coal, which are directly or indirectly necessary for the production of armaments, and foodstuffs such as sugar butter and bacon, whose prices might be affected by the building-up of emergency stores of provisions.

On the other hand, rearmament activity has in a number of cases restricted the volume of foreign trade. As has already been seen,¹ the value of Japanese exports to countries other than those of the "yen-bloc" slumped seriously between 1937 and 1938. This was largely a result of the placing of the Japanese economy upon a war footing. There developed a considerable scarcity of raw materials for production for the export market; and with the growing competition of the war industries for labour, materials and capital equipment, costs of production were raised in industries producing for the export market. Since the expansion of Japanese export markets had depended primarily upon the competitive power of very low prices, this rise in costs severely restricted exports in the free markets.

Similar difficulties on a smaller scale were experienced in Germany, and to a still smaller extent in the United Kingdom. In both these countries, costs of production were maintained in many manufacturing industries by the competition of Government demands for armaments; and, as the following figures show, the reduction in the quantum of their exports was considerably greater than that of the United States, where this factor was not at work.

Percentage change, between 1937 and 1938, in:

	Gold price of manufactured exports	Quantum of manufactured exports
Germany.	+ 4%	— 13 to — 14%
United Kingdom	+ 1 to + 2%	— 12 to — 13%
United States	— 1 to — 2%	— 4 to — 5%

In Germany, the value of exports of coal and coke, for which the domestic demand was much increased by the production of

¹ Cf. Chapter I, page 39.

iron for armaments, declined by 123 million marks between 1937 and 1938 in spite of the fact that the prices obtainable in the world markets were higher in 1938. Similarly, exports of iron and crude iron products fell by 70 million marks, while imports of iron ore and mineral ore increased by 100 million marks. As is shown by the figures already given in Chapter I,¹ the decline in the value of German exports continued in the first quarter of 1939.

BALANCES OF PAYMENT

The changes in world trade, which have resulted from fluctuations in business activity and from rearmament expenditures, have had marked effects upon the balances of trade of various countries. The most outstanding change was the growth of the excess of exports over imports of the United States during 1937 and 1938. With the trade recession in the United States, expenditure upon imports declined very heavily. But economic activity was maintained in a number of other industrialised countries such as Germany and, to a lesser extent, the United Kingdom by armament expenditures, so that the United States' sales in export markets declined much less than her expenditure upon imports. As is shown by the graph on page 174, imports fell very rapidly in relation to exports after the first half of 1937; but there has been some reversal of this movement since the middle of 1938, as a result of the partial recovery in American demand for imports.²

As the graph on page 174 shows, France, Italy and Japan were also among the industrialised countries in which the ratio of exports to imports increased between 1937 and 1938. In France, the improvement in the balance of trade,³ was due mainly to the depreciation of the franc to a point which enabled French products to compete on better terms in the world markets. This advantageous relation between French prices and world prices was no longer disturbed, as had previously been the case since 1936, by an equally rapid rise in internal prices and costs.

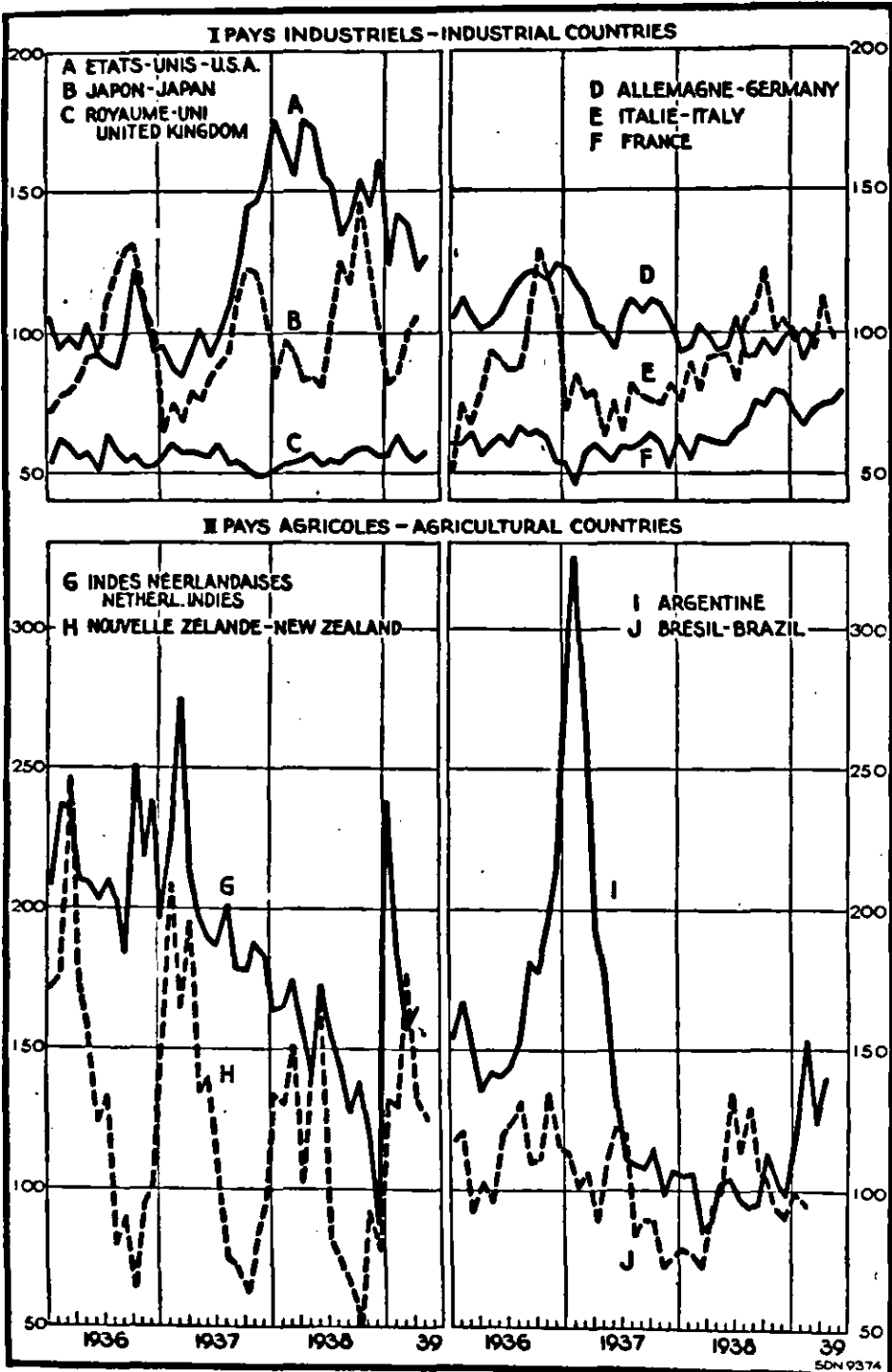
The improvement in the balance of trade of Japan and Italy was brought about by a severe quantitative restriction of imports. In Italy, this enabled a net deficit of over 500 million lire on the clearing accounts with other countries to be completely repaid between the middle of 1938 and March 1939. In Japan, the increase in the proportion between total exports and total imports has not brought any substantial relief to the foreign

¹ Cf. page 32.

² Cf. also Chapter I, page 15.

³ Cf. also Chapter I, page 27.

Value of Exports as a Percentage of Value of Imports.



exchange position. For, as the following figures show, there has been a large increase since 1936 in the surplus of exports to the countries of the "yen-bloc" from which no free foreign exchange is obtainable; but there has been an equally marked increase since 1936 in the surplus of imports from the other countries, to the majority of which free exchange must be paid for imports.

Japan: Excess of Value of Exports (+) or of Imports (—).

Yen (000,000's).

	1936	1937	1938
General trade with:			
(a) Manchuria, Kwantung and China ^a	+ 215	+ 357	+ 630
(b) Other countries	— 328	— 1,002	— 603

^a Manchuria, Kwantung and the parts of China proper absorbing the bulk of Japanese exports belong to the "yen-bloc".

In Germany, on the other hand, as the graph shows, an excess of exports in 1937 gave place to an excess of imports in 1938.¹ Expenditure on imports was maintained by the heavy Government demands for rearmament purposes; and at the same time the recession in world demand restricted German export markets, and larger quantities of exportable commodities were consumed internally as a result of the rearmament activity. The excess of imports was financed by the use of such reserves as the newly acquired gold and foreign exchange of the former National Bank of Austria, and by the mobilisation of various foreign exchange reserves in private ownership.² In the United Kingdom, the ratio of exports to imports remained practically unchanged; for certain unfavourable factors, such as a high demand for imports for rearmament purposes and the fall in the world demand for exports, were counterbalanced by a moderate depreciation of the pound and by a reduction in the unit price of imported raw materials.

The ratio of exports to imports fell during 1937 and 1938 in many of the countries producing raw materials and foodstuffs. This movement is particularly clear in the case of the Argentine and the Netherlands Indies in the graph on page 174. The value of the exports of such countries naturally fell more heavily

¹ Cf. Chapter I, page 32.

² This is estimated to have yielded 1,000 million marks, or a sum equivalent to nearly 20% of Germany's total imports in 1937. Cf. *Ninth Annual Report of the Bank for International Settlements*, page 43.

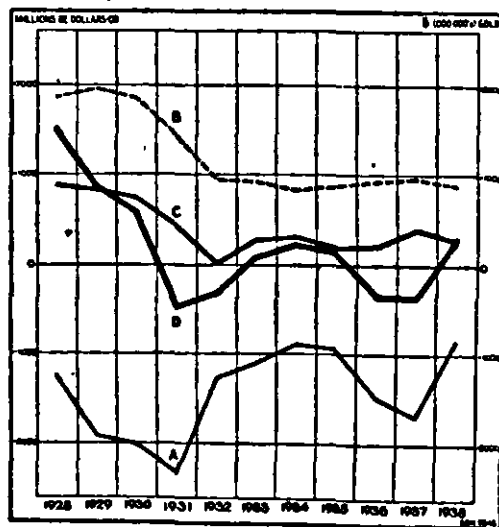
than the value of their manufactured imports because the fall in the prices of primary products was much greater than the prices of industrial products. In addition to this, there was, as is normal, a considerable time-lag between the reduction in the receipts of agricultural countries from the sale of their exports and the consequent reduction in their expenditure upon imports.¹ In fact, the majority of the agricultural countries increased their imports of capital equipment between 1937 and 1938. Imports of machinery, for example, rose in value by 15% in the Netherlands Indies and Denmark, by more than 20% in India and British Malaya, by more than 30% in the Argentine, by more than 50% in Turkey and by more than 60% in Poland. The graph on page 174 suggests that, with the recovery in the United States and other industrialised countries, there was an improvement in the ratio of exports to imports of the agricultural countries at the end of 1938 and the beginning of 1939.

As the graph on this page shows, the balance of payments of the three main industrialised creditor countries — the United Kingdom, the United States and France — had, apart from capital movements, shown an excess of outward payments in 1936 and 1937. The sharp change in conditions in 1938, and in particular the export surplus of the United States, turned this excess of payments into an excess of receipts from other countries.

In previous years, the debtor countries had used their excess receipts from the industrialised creditor countries, together with the proceeds of their sales of newly produced gold, to repay their foreign indebtedness or to build up short-term balances in the United Kingdom and the United States.² The change in 1938, in the

Combined Balances on Account of Current International Payments and Receipts of the United States, the United Kingdom and France.

- A Goods.
- B Interest and dividends.
- C Other services.
- D Total current items.



¹ Cf. Chapter I, pages 41-44.

² Cf. *Balances of Payments, 1937* (League of Nations), pages 21 to 24.

absence of any renewed lending from the creditor to the debtor countries, imposed a strain upon the balances of payments of the agricultural debtor countries. A number of such countries lost reserves of gold or of foreign exchange; and in Chapter III (pages 101 and 102) the effect of these losses of monetary reserves upon their monetary policies has already been discussed. A number of them allowed the value of their currencies in the foreign exchange market to depreciate (*cf.* page 184 below); and many of them imposed more rigid controls over foreign exchange payments, as will be seen in the next Chapter (page 196).

MOVEMENTS OF GOLD AND CAPITAL ¹

In the period covered by this *Survey* there has been no appreciable recovery of long-term lending by the developed creditor countries to the countries with a relative scarcity of capital, which had been a normal feature of the pre-1929 world economy. In recent years, indeed, repayments of existing foreign loans by redemption and amortisation has exceeded the issue of new foreign loans on the principal capital markets. Australia raised a long-term loan on the London market, and the Argentine on the New York market, during 1938; an agreement has recently been reached for a long-term loan from the United States to Brazil; and the French Government raised certain funds in Belgium and the Netherlands. In addition, a certain number of Governments extended guaranteed credits to the Governments of other countries for specific economic, financial or, in some cases, political reasons.²

But, broadly speaking, the only international capital movements of any size in recent months have taken the form of movements of short-term funds from one currency to another or of investments in existing securities on the Stock Exchange of one highly developed country by the nationals of another such country. These movements of capital have taken place with relatively little reference to the differences in the yield of capital in different national economies, and they have been primarily influenced by considerations of political safety or by fears of exchange depreciation of a particular currency.

In the last quarter of 1937 and for the first half of 1938, as the following figures show, the heavy flow of capital into the United States gave place to a very substantial withdrawal of

¹ *Cf. Money and Banking, 1938/39 (League of Nations), Volume I, Chapter A.*

² *Cf. Chapter VIII, pages 191 and 192.*

foreign funds. This withdrawal of funds took the form of a sale of dollar balances and other liquid funds rather than of securities which had been previously purchased on the New York stock exchange. It seems, therefore, to have been due rather to the fear that the dollar might be devalued as a measure to counteract the internal American recession than to the desire to sell American securities during the slump on the New York stock exchange. In the second half of 1938, the movement of funds into the United States started once again on a large scale, as a result of various factors such as the recovery in the United States which removed the possibility of a deliberate dollar depreciation, the fear of a continuing depreciation in the exchange value of the pound, and the increased apprehensions about the political situation in Europe.

*United States: Movement of Capital and Gold,
and the Balance of Trade.*
\$(000,000's).

Quarters	Total inflow or outflow (—) of capital	Excess of merchandise exports or imports (—)	Gold imports (including earmarking transactions)
1936 I	102.5	— 73	24
II	453.5	— 15	448
III	314	— 46	216
IV	325	59	343
1937 I	323	— 83	339
II	630.5	— 31	651
III	350	86	394
IV	— 502	317.5	1
1938 I	— 213	323	43
II	— 161	305	109
III	407	205	688
IV	336	275	801
1939 I	356	177	721
II . . . .	...	151*	747*

* Provisional.

The outflow of capital from the United States in the last quarter of 1937 and the first half of 1938 would probably have been accompanied by an outflow of gold if it had not been for the large excess of merchandise exports which developed during the recession. After the middle of 1938, the inflow of gold into the United States rose to an extremely high level as the result of the combination of an excess of merchandise exports and a renewed inflow of capital funds. Whereas in previous years the inflow of gold had been due primarily to the flow of capital

to the United States, the above figures show that, for 1938 as a whole, the export surplus was much more important than the inflow of capital in explaining the flow of gold into the country¹.

France had been subjected to a steady export of capital for some years before 1938. But immediately after the decision in May 1938 to prevent any depreciation of the franc below the rate of 179 to £1, there was a considerable repatriation of funds, estimated at from 16,000 to 18,000 million francs.² Between the end of May and October 1938, the greater part of these funds were re-exported again, largely as a result of the growing political tension in Europe; but, after the financial and economic reforms of November 1938,³ a steady repatriation of funds took place, which continued through the winter and during the first half of 1939. The extent of these movements of capital funds may be judged from the following figures of the gold holdings of the French Exchange Stabilisation Fund:

*Gold held by French Exchange Stabilisation Fund.**

Francs (000,000's).

End of May 1938.	20,000 — 21,000
October 1938	2,067
February 1939.	17,423

* The figure for May 1938 is an unofficial estimate (cf. *L'Activité économique*, October 1938, page 238) and may not be strictly comparable with the official figures for October 1938 and January 1939; but the general movement is probably well represented by the figures.

It was stated by the French Minister of Finance in the middle of May 1939 that the inflow of funds had continued up to that date and that there had been no setback even during the international political tension of March 1939. In April, the Exchange Stabilisation Fund sold 5,000 million francs of gold to the Bank of France in order to replenish its reserves of francs for the purchase of further gold imports.

The renewed inflow of capital into the United States, combined with the repatriation of funds into France, caused a drain of foreign funds from London.⁴ The effect of this drain of funds is illustrated by the following figures of the British gold reserves. The most marked fall is recorded between March and September 1938, as a result of the heavy withdrawals of funds to the United States during the summer of 1938; but the drain of funds continued during the winter of 1938/39,

¹ Cf. the following statement of Mr. MORGENTHAU, Secretary of the United States Treasury: "The best way to reduce our gold inflow on commodity and service account is for us to have full recovery so that our imports will rise more rapidly than our exports".

² Cf. *Ninth Annual Report of the Bank for International Settlements*, page 80.

³ Cf. Chapter I, pages 29-31.

⁴ The internal effects of this drain of funds are discussed in Chapter III, pages 96 to 98.

*Combined Gold Reserves of the Bank of England
and the Exchange Equalisation Fund.*

Value in £(000,000's) at £7 per fine ounce.

1937	1938 ¹		1939
September	March	September	March
817	836	690	560

although at a slightly reduced rate. In addition to the withdrawal of capital to the United States and to France, the reasons for which have already been examined, there was a third factor at work. The countries of the "sterling-group" had enjoyed a favourable balance of payments in 1936 and 1937; and they had used part of the excess of their receipts from other countries to build up sterling reserves in the form of balances of funds held in London. But, as the following figures show, these balances were considerably reduced during 1938.

*Central Foreign Assets Reserve of Fifteen
"Sterling-group" Countries.**

	£(000,000's).			
End of:	1935	1936	1937	1938
	204	222.5	256	208

* Australia, Denmark, Egypt, Estonia, Finland, Iraq, India, Ireland, Latvia, New Zealand, Norway, Portugal, Sweden, Thailand, Union of South Africa.

This reduction was due primarily to the fact that the balances of payments of the many agricultural countries contained in this group became unfavourable during the recession in world trade; but there was also a tendency on the part of these countries to convert their holdings of foreign exchange into gold. In New Zealand, the loss of foreign assets was also intensified by some export of capital during 1938.¹

In addition to the agricultural countries of the "sterling group", a certain number of other countries which produce primary products lost reserves of gold and foreign exchange during 1938. Thus the gold and foreign exchange reserves of the Banco Central of the Argentine fell from 1,568 to 1,296 million pesos between June 1937 and December 1938; and the foreign exchange reserves of the Central Bank of Ecuador fell from 29 to 4 million sucres in the same period.²

¹ Cf. Chapter III, page 102.

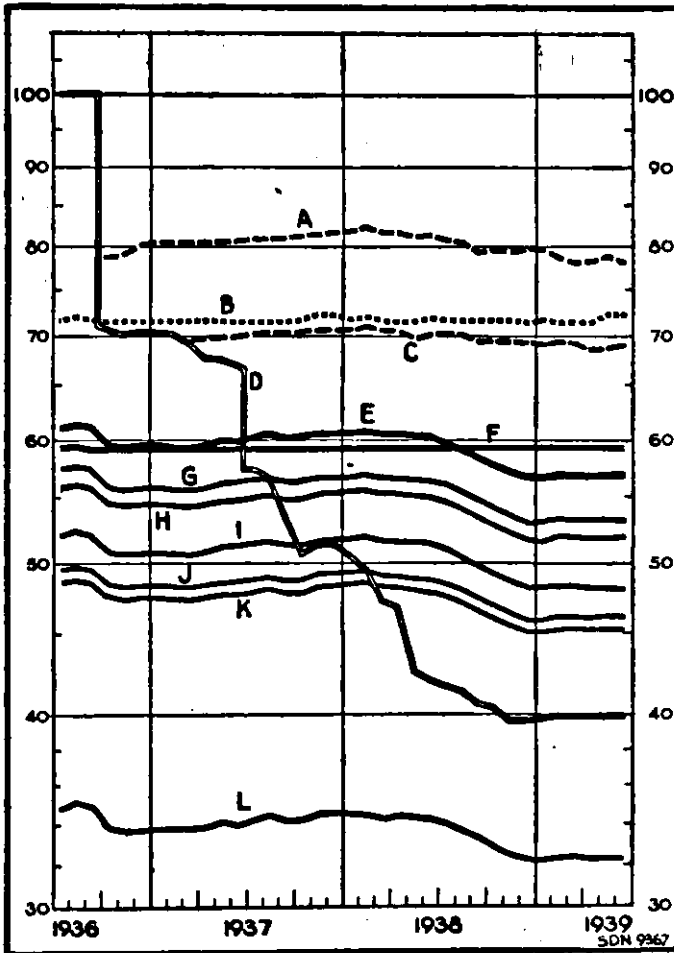
² The effects upon internal monetary policy of the loss of reserves by these agricultural countries are discussed in Chapter III, pages 101 and 102.

Japan and Belgium were prominent among the few industrialised countries whose recorded central monetary reserves of gold were reduced during 1938. In the case of Japan, the heavy import requirements of the war, combined with the collapse of the export trade to countries with free exchanges outside the "yen-bloc" area, necessitated the use of part of the gold reserves for the finance of imports. In July 1938, the gold stock of the Bank of Japan was reduced from 801 to 501 million yen by the transfer of 300 million yen to a "revolving fund" to

Gold Value of Certain Currencies.

(In % of their parity in 1929.)

- | | | |
|----------------|-------------------|--------------|
| A Netherlands. | E United Kingdom. | I Finland. |
| B Belgium. | F United States. | J Denmark. |
| C Switzerland. | G Sweden. | K Australia. |
| D France. | H Norway. | L Japan. |



finance the import of raw materials necessary for the export industries.

In Belgium, the depreciation of the French franc in May 1938 gave rise to some export of capital, and in consequence the National Bank of Belgium lost gold. Later in the year, the gold reserves rose again, but in the spring of 1939 there was a renewed drain of funds from Belgium. The Belgian currency is tied rigidly to gold, and these drains of funds from Belgium have been met by the orthodox methods of internal credit restriction.¹

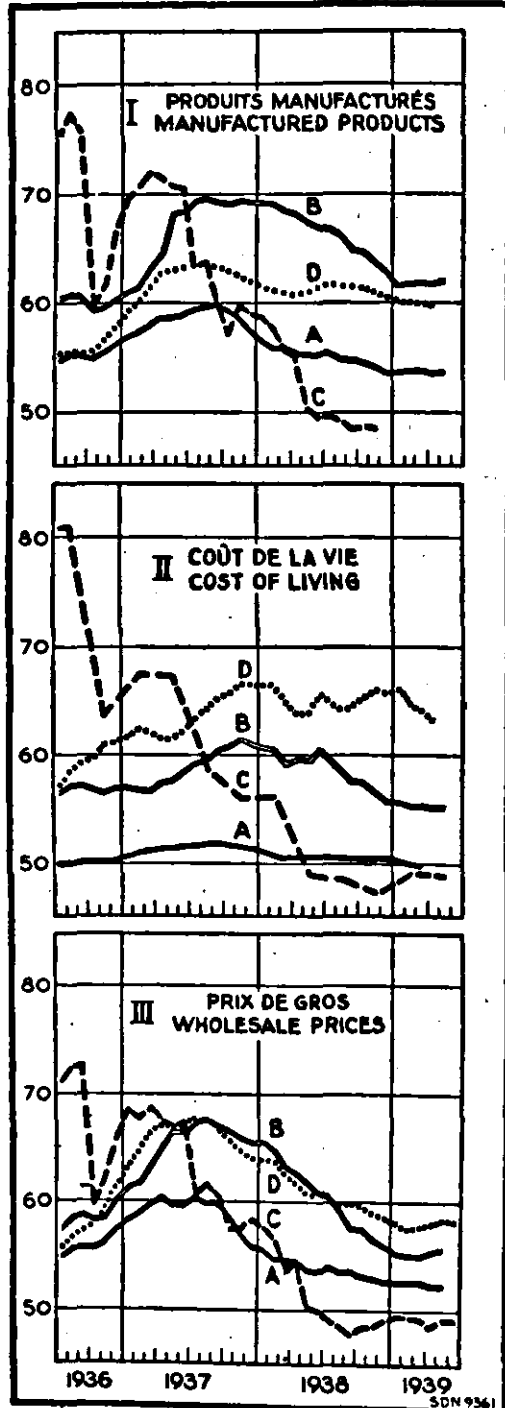
¹ Cf. Chapter III, page 91.

THE FOREIGN EXCHANGES ¹

The graph on page 181 makes clear the two most important recent developments in the foreign exchange market: the rapid depreciation of the French franc since 1936, and the moderate depreciation of the pound and of the countries of the "sterling-group" since the middle of 1938. The depreciation of the French franc was halted in May 1938, when a lower limit of 179 francs to the pound was set; and, as has already been shown,² the cessation of the rapid rise in internal prices and costs enabled the depreciation to be successfully checked at this point. The fall in the gold value of the franc since the middle of 1938 has been an accompaniment of the decline in the gold value of the pound, and the franc has not depreciated further in value in terms of sterling. The graph on this page illustrates how this recent depreciation in the French franc, in the absence of further rapid increases of internal prices, has increased the competitive position of French products in world markets. French gold prices in the first half of 1937 were higher in relation to the 1930 level than in the United States, the United

Price Indices in Terms of Gold.
(1930 = 100.)

A United States. C France.
B United Kingdom. D Belgium.



¹ Cf. *Money and Banking 1938/39*, (League of Nations), Volume I, Chapter A.
² Cf. Chapter I, pages 27.

Kingdom or Belgium; but in the last half of 1938 they were lower than in any of these countries.

As can be seen from the graph on page 181, the pound depreciated some 7% in terms of dollars in the course of 1938, and there was a similar depreciation of the currencies of the various countries — including Japan — which keep the value of their currencies fixed in relation to the pound. The depreciation of the pound was the natural result of the pressure upon sterling which was exercised by the outflow of capital to which reference has already been made.¹ The pressure due to capital movements was probably intensified by an unfavourable balance of current international receipts and payments. If abnormal movements of silver are left out of account, the excess of current international payments over receipts of the United Kingdom rose from £45 million to £66 million between 1937 and 1938.

Moreover, British prices had become less competitive in relation to American prices in the course of 1937, as can be seen from the graph on page 182. In the active business conditions of the first half of 1937, prices rose more rapidly in the United Kingdom than in the United States — largely because reserves of unemployed economic resources were smaller in the United Kingdom. During the second half of 1937, the recession was more serious in the United States than in the United Kingdom, with the result that American prices fell more rapidly than British prices. The graph suggests that, in the course of 1938, the depreciation of the pound in terms of the dollar to some extent — but by no means entirely — closed this gap between American and British gold prices which had developed since the beginning of 1937.

A few countries whose currencies were tied to gold or to the dollar were subjected to a certain degree of pressure during 1938, partly as a result of the depreciation of the pound which increased the competitive power of British exports. Belgian exports are to a large extent in direct competition with the products of the United Kingdom; and as the graph on page 182 shows, United Kingdom prices expressed in gold fell relatively to Belgian prices during 1938. Moreover, the depreciation of the French franc greatly reduced French gold prices relatively to Belgian prices; and, although the Belgian economy is less directly in competition with the French economy, this also exercised some pressure upon the Belgian exchanges. Between 1937 and 1938, however, the Belgian balance of trade did not deteriorate, as imports were reduced in value even more quickly

¹ Cf. Chapter VIII, pages 196 and 197, for the measures which have recently been taken to strengthen the position of sterling by controlling the purchase of foreign currencies for certain purposes.

than exports. But there was some export of capital which led to an export of gold; and, as has already been seen, an orthodox policy of monetary restriction was adopted to preserve the fixed gold value of the currency.¹

As a result of the financial strain imposed by the invasion of China, the Chinese dollar depreciated by 45% between the end of 1937 and the end of 1938.² Moreover, the currencies of a number of agricultural countries were also depreciated during the second half of 1937 or in the course of 1938 as a result of the pressure upon their balances of international payments which resulted from the recession in world trade.³ This movement was particularly marked in the countries of South America, as can be seen from the following figures:

Gold Value of Various South-American Currencies.

(As % of gold parity in 1929.)

Country	Currency	July 1937	Dec. 1937	Dec. 1938	May 1939
Argentina . . .	Peso: Official rate	46.1	46.4	43.3	43.4
	Free rate	42.0	40.8	31.6	32.2
Bolivia.	Boliviano	9.8	8.0	5.3	5.3
Chile	Peso: Official rate	25.1	25.1	25.1	25.1
	Free rate	18.5	19.1	15.1	14.0
Peru.	Sol	38.1	36.1	30.4	27.7
Uruguay	Peso: Official rate	45.3	45.7	35.1	35.2
	Free rate	33.0	36.6	20.4	20.2

For the same reasons, the severity of exchange control in certain of these countries and in a number of other agricultural countries was intensified during this period; and this development will be examined in the following chapter.

¹ Cf. Chapter III, page 91.

² For more recent changes in the value of the Chinese dollar, cf. Chapter IX.

³ Cf. pages 175-177 above.

Chapter VIII.

COMMERCIAL POLICY

CONFLICTING TRADE POLICIES AND THE FORMATION OF ECONOMIC *Blocs*

The depression of economic activity during the post-1929 slump and, more recently, considerations of political strategy and of national defence have led to methods of commercial protection and regulation which have caused a partial disintegration of world export markets. Before 1929, national markets were, in many cases, protected by high tariffs; but the absence of exchange controls and of clearings, the relative scarcity of quantitative restrictions upon imports, and the general avoidance of tariff discrimination gave rise to comparatively well integrated world markets for the majority of exportable products.

The subsequent disintegration of world markets is well illustrated by the tendency to form more or less clearly defined "economic blocs" of countries with which the principal trading nations have specially close economic ties. As the table on page 186 shows, empire trade has become more important in the cases of such countries as the United Kingdom, France, the Netherlands and Italy. Such trade has been encouraged by preferential treatment, such, for example, as the preferential tariffs developed in the British Empire by the Ottawa Agreement of 1932. But it is not only imperial trade which has been encouraged in this way. Currency blocs, such as the "sterling bloc", have encouraged trade between certain countries; for currency stability itself stimulates trade and successful and effective commercial agreements are more easily effected between the members of such currency groups.

At the same time, the institution of exchange controls and of exchange clearings has led to a stimulation of bilaterally balanced trade between the countries which have adopted these measures. By various methods, which will be discussed in a later section of this chapter, Germany has promoted her trade with South-Eastern Europe and with certain countries of Latin America; and, as the table shows, these blocs of controlled trade have grown considerably in importance to Germany. Similarly,

Trade with "Economic Blocs" as a Percentage of Total Trade of Certain Countries.¹

Country	"Economic Bloc" ^a	Imports from "Economic Bloc" as percentage of country's total imports		Exports to "Economic Bloc" as a percentage of country's total exports	
		1929	1938	1929	1938
United Kingdom ^a	British Commonwealth, colonies, protectorates, etc.	30	42	44	50
	Other countries of the "sterling bloc" ^b	12	13	7	12
France	French colonies, protectorates and mandated territories	12	27	19	27.5
Belgium	Belgian Congo	4	8	3	2
Netherlands	Netherlands oversea territories	5.5	9	9	11
Italy	Italian colonies and Ethiopia	0.5	2	2	23
Portugal	Portuguese oversea territories	8	10	13	12
Japan ^a	Korea, Formosa, Kwantung, Manchuria	20	41	24	55
Germany	Six countries of South-Eastern Europe ^c	4.5	12	5	13
	Latin America	12	16	8	11.5

^a General trade.

^b Sweden, Norway, Finland, Denmark, Egypt, Estonia, Latvia, Portugal, Thailand and Iraq.

^c Bulgaria, Greece, Hungary, Roumania, Turkey and Yugoslavia.

the importance of trade with the "yen bloc" has grown in the case of Japan, both because of the existence of common currency arrangements and also because of the control of foreign exchanges and of trade movements between this area and the rest of the world.

These developments have much reduced the scope of multi-lateral trade. One of the chief objects of clearing agreements is in most cases to balance more or less exactly the exports and imports of the two partners to the clearing. Whereas, in 1929, such agreements were unknown, it is estimated that, in 1937,

¹ Cf. League of Nations, *Review of World Trade, 1938*, pages 34 and 35.

about 12% of world trade passed through such bilateral clearings. For some countries, the proportion of trade passing through clearings was very high, exceeding 50% in 1937 for Bulgaria, Germany, Greece, Hungary, Yugoslavia, Roumania and Turkey.¹

In previous years, the debts due by their empires to such creditor countries as the United Kingdom and France were paid in large part indirectly through the export of colonial products to third countries, such as Germany, which, in turn, exported surpluses of their manufactured products to the creditor countries. As the following figures show, since 1929, the creditor countries have increased their import surpluses from their empires and have decreased their import surpluses from other countries. This development represents a closer bilateral balancing of transactions, since the oversea territories are now paying their debts more directly by a surplus of their exports to the creditor countries; debtor countries find that the markets for their specialised primary products are more restricted.

*Excess of Imports (—) or of Exports (+) of Certain
Creditor Countries.²*

\$ (000,000's) Gold.

	1929	1938
United Kingdom:		
With the rest of the British Commonwealth of Nations	— 55	— 362
With other countries	— 1,803	— 758
France:		
With French colonies, protectorates and mandated territories	+ 96	— 70
With other countries	— 412	— 196
Belgium:		
With Belgian Congo	— 13	— 22
With other countries	— 91	— 2
Netherlands:		
With Netherlands oversea territories . . .	+ 14	— 4
With other countries	— 321	— 118

Although the tendency since 1929 for the formation of "economic blocs" and for the development of bilateral trade has been widespread, yet there is at present a sharp contrast between two distinct commercial policies. On the one hand,

¹ Cf. "World Trade", *Journal of the International Chamber of Commerce*, February 1939, page 10.

² Cf. League of Nations, *Review of World Trade, 1938*, page 36.

there are countries, such as Germany, whose trade is organised bilaterally through clearings and quantitative control of imports, whose foreign exchanges are closely regulated, and whose exports are frequently directly subsidised. On the other hand, there are countries — typified by the United States of America — whose foreign exchanges remain uncontrolled and whose imports are restricted by tariffs rather than by quantitative quotas.

Moreover, the commercial policy of the United States is to conclude as rapidly and extensively as possible a series of agreements for the reduction of trade restrictions. These agreements are based upon the principle of non-discrimination in foreign trade, although there are some exceptions to this principle. Thus, the United States does not extend the benefits of these agreements to Germany, on the grounds of German discrimination against American trade. Special countervailing duties are also imposed on the import of subsidised goods. In April 1939, an additional 25% duty was imposed on all dutiable goods imported from Germany, including goods from Czecho-Slovakia, unless it could be shown that the goods were not subsidised; and, in July 1939, it was announced that special countervailing duties would be imposed on the import of subsidised silk goods from Italy.

In the period covered by this *Survey*, both of these conflicting trading systems have made further progress, as will appear in later sections of this chapter. The move towards a greater liberalisation of trading conditions is exemplified by the resolution unanimously approved at a conference of all American States at Lima in December 1938, recommending the reduction of restrictions upon international trade on non-discriminatory principles; and the conclusion of the Anglo-American trade agreement in November 1938 effected a non-discriminatory liberalisation of trade of outstanding importance. On the other hand, the continued trade drive in South-Eastern Europe by Germany illustrates the development of the opposing type of trading system; but, in spite of the rapid development of such controlled trade in recent years, it has been estimated that over 70% of the world's trade is still carried on by countries operating on a predominantly open and competitive basis.¹

While the distinction between the two types of commercial policy is in some cases very marked, it is not always clear-cut. For example, as the following figures show, even in the case of countries which have maintained freedom of exchange dealings, a considerable percentage of imports is subjected to quantitative, as opposed to tariff, restrictions.

¹ U.S. Department of Commerce, *Commerce Reports*, February 4th, 1939.

*Approximate Percentage of Total Value of Imports in 1937
subject to Licence or Quota Restrictions.*

France.	58	Ireland	17
Switzerland.	52	Norway	12
The Netherlands	26	United Kingdom	8
Belgium	24	Sweden	3

Barter transactions of one kind or another are pre-eminently associated with the countries adopting a fully regulated system of bilateral trade. But in June 1939, negotiations were concluded between the Governments of the United States of America and the United Kingdom for the barter of 600,000 bales of American cotton for approximately 80,000 tons of rubber for the formation of emergency war stocks.

The conflict of commercial policies is well illustrated in the development of the trading system of the United Kingdom. British trade is, in the main, still conducted on open and competitive principles. There is no control of the foreign exchanges for commercial payments. In 1937, only 8% of the country's imports was subject to quantitative restrictions, and only 2%¹ of its trade was effected through clearings, which have been set up only when it was necessary to do so in order to regulate the collection of commercial debts from other countries with exchange controls. But, since the abandonment of free trade in 1931, a number of modifications of these liberal principles have been introduced, in many cases as a direct or indirect result of the development of controlled trade in Germany and other countries. In 1932, the principle of imperial preferences was consolidated in the Ottawa agreements. Quantitative quota restrictions have been introduced for a number of agricultural products for the regulation of internal agricultural prices and production. Certain trade agreements concluded with the Scandinavian countries since 1933 have been based to some extent upon the principle of the bilateral quantitative regulation of trade; an Anglo-Danish treaty of 1933, for example, guaranteed to Denmark a certain percentage of the total United Kingdom imports of bacon in return for a guarantee to the United Kingdom of a certain percentage of the Danish purchases of coal. In 1936, clearing arrangements were set up for British trade with Turkey, Italy and Roumania in order to reduce commercial debts from these countries. The system of direct Government aid to the export trade through the provision of

¹ Cf. "World Trade", *Journal of the International Chamber of Commerce*, February 1939, page 10.

export credit guarantees has recently been much developed. Unofficial restrictions on foreign-exchange speculation and on movements of capital funds abroad have recently been considerably increased. In April 1939, direct Government subsidies were announced to promote British shipping and British shipbuilding.

In May 1939, a comprehensive commercial agreement was reached between the United Kingdom and Roumania, which envisaged the formation of a joint trading organisation to stimulate commerce between the two countries. This agreement also included the grant of a credit of £5 million by the United Kingdom to Roumania; and the Food Defence Department of the United Kingdom, which had already purchased 200,000 tons of Roumanian wheat in October 1938, undertook to purchase a similar quantity of wheat from the next harvest, if it were made available at world prices.

Perhaps the most significant developments in the trade policy of the United Kingdom in the early months of 1939 were the contacts which were made between British and German industrialists in order to agree upon the basis of competition in foreign markets. In January 1939, it was announced that "meetings between the representatives of the British and German coal industries have succeeded in settling all points of difference"; and it was expected that agreement on the percentage distribution of coal exports would be reached, which might lead to an inclusive European coal cartel. In March 1939, a statement was issued by representatives of British and German industrialists to the effect that destructive competition should be replaced by industrial agreements between the individual industries in the two countries, and that these agreements should be extended to include producers in other countries. It was further agreed that British and German industrialists should seek the help of their Governments to counteract competition from the industries of other countries which refused to become parties to the agreement, if such competition threatened to nullify the agreement. The prospect of an extensive system of industrial cartels, determining prices and sales in export markets and strengthened by official support, suggested an important modification of the principles of open competition upon which the commercial policy of the United Kingdom had been largely based. These negotiations were, however, indefinitely postponed as a result of the German occupation of Czecho-Slovakia in March 1939.¹

¹ At the same time, trade negotiations which were then proceeding between France and Germany were broken off. Subsequently, however, it was agreed to prolong the existing trade agreement between France and Germany with certain revisions.

THE EXTENSION OF INTERNATIONAL CREDITS

In the years before the post-1929 slump and the financial crisis of 1931, there had been a considerable flow of long-term capital from the creditor to the debtor countries, and a considerable volume of international trade was financed through these capital movements. As has been seen in the previous chapter, there has been little, if any, revival of this form of international capital movements, and the main movements of capital in recent years have been short-term movements of "hot money" between the main creditor countries themselves.

But, in the course of 1937 and 1938, there has been a considerable extension of international lending in the form of loans and credits granted by Governments or guaranteed by Governments, both for the purpose of encouraging export trade and also, in some cases, for non-commercial reasons. These credits have, in many cases, taken the form of export credit guarantees.

In the United Kingdom, the total business done by the Export Credit Guarantee Department has greatly expanded in recent years; and the total value of contracts, policies and guarantees has grown from £7.5 million to £43 million between 1933/34 and 1937/38. At the beginning of 1939, the total liability which the department could assume was extended from £50 million to £75 million; and, at the same time, it was decided that an additional £10 million could be guaranteed in cases which appeared to be in the national interest, even though no guarantee could have been given on the commercial principles which governed the rest of the department's activities. In July 1939, a Bill was introduced to extend the limits of this latter type of guarantee from £10 million to £60 million.

Important credits have been extended to various Governments. In May 1938, export credits of £10 million and an arms loan of £6 million were granted to the Turkish Government. More recent arrangements have been made for credits of £2 million to the Greek Government, of £5½ million to the Roumanian Government and of £8 million to the Polish Government. In July 1939, a credit of £5 million was extended to the New Zealand Government together with export credits of £4 million for other New Zealand importers. In March 1939, a stabilisation fund of £10 million was set up to protect the Chinese currency; and, of this sum, £5 million was provided by the Chinese Government banks and £5 million by British banks, under the guarantee of the British Treasury.

In May 1939, a French credit of 60 million zloty was extended to Poland for electrification schemes; and the repayment of the interest was arranged through additional Polish exports to France, for which allowance was made in an amendment to the trade agreement.

The United States of America has also used the method of granting credits in order to support her foreign trade; and many credits have recently been arranged through the Export-Import Bank, which was specially instituted for this purpose. A loan of \$10 million has been extended to a large American utility firm to support its operations in Latin America; a credit of \$6 million has been granted to Poland to finance the purchase of American cotton and copper; a credit of \$25 million has been granted to China for the finance of American exports; in June 1939, a revolving credit of \$500,000 was granted to Paraguay for the finance of trade and the stabilisation of the currency, and, in addition, a seven-year credit was granted to the Government of Paraguay for the finance of construction projects; and credits have also been granted to the Argentine for the import of American cars, and to Portugal for the purchase of railway equipment.

In March 1939, a comprehensive financial agreement was reached between Brazil and the United States. The United States Treasury was to provide a credit of \$50 million for the formation of a Brazilian foreign-exchange fund to protect the currency and to aid in the formation of a central bank; and the Export-Import Bank, in addition to making advances of about \$20 million for the unfreezing of commercial debts due to American exporters to Brazil, granted a long-term loan of \$50 million for the purchase of United States manufactures. In return, Brazil undertook that payment would be resumed on the service of her debts to the United States; and the agreement was followed by a limited removal of Brazilian exchange controls.¹

Export credit guarantees are used in one form or another by many other countries, including Germany, for the promotion of their export trade; and there have been many recent extensions of this system. For example, in Belgium, the maximum limit of credit guarantees was raised in August 1938, and, in Finland, the system was enlarged in September 1938.

THE UNITED STATES' TRADE AGREEMENT PROGRAMME AND THE LIBERALISATION OF TRADE

Since 1934, the most important attempt to liberalise trade has been that undertaken by the United States of America in

¹ Cf. page 195.

the prosecution of its programme of trade agreements. By the spring of 1939, agreements had been concluded with twenty countries¹ covering about 60% of the United States trade. In all these agreements, mutual reductions of trade barriers have been granted upon the principle of the most-favoured-nation clause, so that the consequent liberalisation of trade has been largely extended to the benefit of other countries.

In the autumn of 1938, a trade agreement was concluded with Ecuador and, in the spring of 1939, with Turkey. But by far the most important development in this programme occurred in November 1938 with the conclusion of a trade agreement with the United Kingdom and the British non-self-governing Empire and with the revision and extension of the existing trade agreement with Canada. The value of total world trade which was covered by these agreements was very great. The trade between the United States and Canada is the greatest between any two individual countries in the world; and as the following figures show, the countries concerned in these agreements accounted for some 35% of the total of world trade in 1938.

	Share in world imports, 1938 %	Share in world exports, 1938 %
United States	8	14
United Kingdom	17	10
British non-self-governing Empire	6	8
Canada	3	4
	34	36
Total		

In the same year, 17% of the United States exports were sold to the United Kingdom, and 5% of the United Kingdom exports were sold to the United States; and concessions were effected on some two-thirds of this trade in the form of tariff reductions or bindings or of guarantees of free entry.

As the United States, the United Kingdom and Canada have all included the most-favoured-nation clause in their previous commercial agreements, the concessions have automatically been extended to the trade of other countries, except that, as has already been seen, the benefits are not extended by the United States to Germany, on the grounds of German discrimination against American trade. The concessions had been granted by both sides upon products of which the other

¹ The rates provided for in the agreement with Nicaragua have been suspended, and the agreement with Czecho-Slovakia is no longer in effect.

party was the principal supplier; and a clause is contained in the agreements by means of which any particular concession can be withdrawn or modified if its main benefit should in fact accrue to a third party. But, in spite of these facts, the extension of the benefits to third parties substantially increases the volume of world trade affected by the agreements.

In addition to the great volume of trade covered, the conclusion of these agreements marked an important expression of commercial principle by the chief trading countries. In particular, it necessitated a relaxation of the system of imperial preferences which had been instituted by the Ottawa agreements of 1932; and, for this reason, it marked an important extension of the principle of equal trading opportunities.

The United States sells a considerable excess of exports to the United Kingdom, but, at the same time, it buys a large excess of imports from the British colonial empire in the form of raw materials such as tin and rubber; and, in consequence, the United States imports and exports which were covered by the agreement with the United Kingdom were well matched in total value.

Whereas former agreements in the United States' trade agreements programme had been mainly to the advantage of American industrialists, in the Anglo-American agreement of November 1938 the chief concessions obtained by the United States were to the advantage of farmers and lumbermen. The granting of concessions on imports of agricultural products by the United Kingdom was, however, complicated by the Ottawa agreements with the British Dominions; for, unless the United Kingdom were radically to modify its internal agricultural policy by admitting much larger supplies, concessions could be granted on American products only by a modification of imperial preferences which would enable American agricultural produce to compete more easily with similar products from the British dominions.

In effect, the United States granted concessions on a wide range of manufactured specialities from the United Kingdom, and, in particular, on textile products. Moreover, the duty on whisky, which constitutes the most important single export from the United Kingdom to the United States, was stabilised at the current rate. The main concessions granted by the United Kingdom were on products such as wheat, hams, fruits, salmon and timber. Many of these concessions — as, for example, the removal of the existing duty of 2s. a quarter on imports of foreign wheat — involved the reduction of imperial preferences to the detriment of the trading positions of Canada and, to a smaller extent, of Australia and South Africa.

In order to make up for these sacrifices, the United Kingdom agreed to reductions in the Ottawa preferences granted by Canada on United Kingdom products. This, in turn, enabled Canada to reduce duties on American products in return for various concessions granted to her by the United States. Thus there was a reduction in the imperial preferences granted both by the United Kingdom and by Canada; and, in both cases, the reduced margin of preference was used not to raise duties on each other's goods, but to lower duties on foreign goods.

A certain number of other measures of freeing trade were taken in the course of 1938.¹ In May 1938, Australia removed almost all her remaining import licence restrictions, and the United States removed Australia from the list of countries which had been denied the generalisation of the tariff reductions granted to other countries under the trade agreements programme. An Anglo-Irish agreement in April 1938 removed the special duties and restrictions which had been placed on the trade between the two countries. Tariff reductions were also reported in Mexico, Venezuela, Uruguay, Finland and Turkey; Bolivia removed import prohibitions imposed on many products in 1936 and 1937; and, in Denmark, import permits were no longer required for a series of commodities. In August and October 1938, the system of exchange control in Roumania was liberalised in such a way that Roumanian exporters of certain products to free-exchange countries were permitted to retain a certain percentage of the foreign exchange so obtained and to use it for the import of merchandise even in excess of previously permitted import quotas. In Brazil, in April 1939, after the grant of credits by the United States to which reference has already been made, the foreign exchanges were largely freed for commercial transactions; but 30% of the foreign exchange obtained from exports must still be delivered to the authorities at the official rate, and importers may only purchase foreign exchange when a permit has been given by the authorities.

In March 1939, France concluded new agreements with Roumania and Yugoslavia. Previously, France had an excess of exports to these two countries, which had resulted in the accumulation of frozen debts due to her by these countries. By the terms of these new agreements, France undertook to increase her imports from Roumania and Yugoslavia. For example, she agreed to import from Roumania in 1939 an amount of oil equal to 25% of the total Roumanian oil exports in 1938, and to purchase more maize from Roumania, although

¹ Cf. Henry CHALMERS: "Foreign Tariffs and Commercial Policies during 1938". *Commerce Reports*, February 4th, 1939.

this involved the reduction of maize imports from Indo-China. The agreement with Yugoslavia gave better Customs facilities to Yugoslav agricultural produce, in spite of the existing policy of strict protection for French agriculture. In August 1939, both France and Belgium-Luxemburg suspended a number of quota restrictions on imports.

BUSINESS RECESSION AND INCREASED RESTRICTIONS

In 1938, the general recession in trade activity, as has already been seen,¹ placed a considerable strain on the balance of trade and so on the foreign exchanges of many agricultural countries. This was the direct cause of increased restrictions on imports and on foreign exchange payments in a number of countries. As from December 1938, importers in the Argentine had to obtain permits for all foreign-exchange purchases, whereas previously those without permits had been able to purchase foreign exchange on the free market at a 20% higher price. In Ecuador, a severe system of import licensing has been adopted. In Poland, Italy and Lithuania, allowances of foreign exchange for foreign travel have been reduced; and, in Poland, all exchange received from invisible exports must now be delivered to the Bank of Poland. In Italy, specially favourable exchange rates are now offered for sums transferred from abroad.

In Yugoslavia, exporters must surrender 50% instead of 25% of the foreign exchange received from exports to countries with which there is no clearing agreement, and there has been considerable extension of the list of goods for which permits are required for import from such countries.

As has been seen in the previous chapter, the foreign-exchange reserves of New Zealand fell rapidly in the last half of 1937 and during 1938 as a result of the recession in foreign buying power and the internal expansive policy which had been adopted. In consequence, a comprehensive scheme of exchange control, combined with quantitative restrictions of imports, was instituted in December 1938. In May 1939, as the foreign-exchange position had not improved as much as had been hoped, severer import restrictions, including the complete prohibition of the import of a number of articles, was announced for the second half of the year. In the United Kingdom, the pound sterling depreciated during 1938 for reasons which have been examined in the previous chapter. In order to relieve the pressure upon the pound, various measures were taken against speculation and capital transfers over the foreign exchanges.

¹ Cf. Chapter I, pages 41 to 44, and Chapter VII, pages 173 to 177.

In December 1938, the banks were requested not to grant facilities for forward exchange speculations, not to make advances on gold to persons other than bullion dealers, and not to carry out forward dealings in gold; and certain restrictions limiting the issue of foreign loans, which had been relaxed early in 1938, were reimposed in full force. In April 1939, the Chancellor of the Exchequer expressed his desire that capital should not be transferred abroad by the purchase of foreign securities for investment. There have been a number of increases in severity of existing exchange restrictions. Thus, Italy in June 1939, following the example of Germany's action in December 1936, imposed the death penalty for serious offenders against the foreign-exchange regulations. Recent increases in exchange restrictions on the Chinese and Japanese currencies, which have resulted from the Sino-Japanese war, are discussed in the next chapter.

Several Customs duties were increased during 1938.¹ In a number of countries, duties on grains had been reduced during 1937 to meet crop shortages; but, with improved crops in 1938, these duties were again raised. The Hague Convention of 1937, by means of which Norway, Sweden, Denmark, Finland, the Netherlands, and Belgium-Luxemburg had attempted to bring about a general liberalisation of their trading relations, was allowed to expire, in view of the unfavourable world economic conditions. In December 1938, the Netherlands passed legislation to enable import tariffs to be used for protective purposes; and, in March 1939, Dutch import duties were raised upon a wide range of commodities. In the course of 1938, import duties were also increased in France, Norway, Sweden, Belgium, Switzerland, Italy, Yugoslavia, Greece and the Netherlands Indies.

The widespread recovery in business activity until the middle of 1937, the recession until the middle of 1938 and the subsequent recovery have caused sharp fluctuations in the demand for primary products; and these changes in demand have in turn led to corresponding variations in the quota restrictions imposed by international agreement on the production or export of various primary products. Thus the rubber quota was reduced by successive stages from 90% to 45% between the second halves of 1937 and 1938; but, with the recovery in demand, it was raised to 50% in November 1938, to 55% in May and to 60% in July 1939. In the case of copper, restriction had been temporarily abandoned at the beginning of 1937; but the quota was reimposed at 105% at the end of 1937, and was reduced to 95% by the third quarter of 1938. In view

¹ Cf. HENRY CHALMERS: *op. cit.*

of the rapid rise in copper prices towards the end of 1938, it was decided to abandon restriction again; but, largely as a result of the failure of the recovery to develop in the United States, restriction was again imposed, and the quota was reduced to 95% by February 1939. In August 1939, however, it was raised again to 105%.

The tin quota, which had been as high as 110% up to the end of 1937, was reduced to 45% by the third quarter of 1938; and as this included production for the formation of a "buffer pool" of tin to be withheld from the market until prices recovered, the effective production for the market had been reduced to 35%. The quota, which no longer included production for the "buffer" pool, was fixed at 40% in February 1939 and at 45% for the third quarter of 1939. In September 1938, the successful formation of a lead-producers' association, controlling about 70% of the total lead production outside the United States, was announced, with the object of restricting production. The price of lead had fallen severely, and stocks of the metal had risen rapidly after the recession in business activity in 1937; and this had stimulated producers to come to an agreement.

The maximum permissible cut of 5% in the sugar export quotas, fixed in the existing international agreement, was imposed in July 1938; and, at the same time, agreement was reached for further voluntary reductions in exports in an attempt to reduce supply to the level of the expected world demand. But, in May 1939, it was decided to increase these quotas. Restriction appeared to need some relaxation as a result of Government purchases of sugar for war storage purposes, of poor sugar-crops in Europe and in India, and of doubts whether Germany would make full use of the export quotas permitted to Czecho-Slovakia.

At present, as a result of bumper crops, large surplus stocks of cotton and wheat exist, neither of which commodities is subject to an international scheme restricting production or export. But an international conference of countries interested in the production of cotton is to take place in Washington in September 1939; and in January 1939, a Preparatory Committee for a world wheat conference met in London, but the meeting was adjourned until September 1939. Meanwhile many countries pay subsidies on wheat exports in a competitive attempt to reduce their large surplus stocks; and the subsidies paid by Canada, the United States, the Argentine and Australia are expected to amount to some \$125,000,000 during the season 1938/39. In July 1939, it was announced that subsidies would be paid on the export of raw cotton and of cotton goods from the United States.

GERMANY'S TRADE DRIVE

The German mark remains one of the few currencies which has not been devalued from its official gold parity; and its consequent overvaluation has greatly affected German trading relations.

The abnormally high value of the mark in terms of other currencies would, in the absence of Government control of foreign trade, have stimulated imports and restricted exports. Imports have been subjected to very rigid quantitative controls; but, in view of the great need for raw materials and foodstuffs to carry out successfully the Government policy of economic expansion, rearmament and storage of essential commodities, it has been found necessary to stimulate exports in order to finance the purchase of essential imports.

Moreover, for various reasons, export markets in certain countries have recently become less readily accessible to German goods. Thus, it is reported¹ that German exports to the Netherlands have been restricted because of the deterioration in the quality of certain products as a result of the use of substitute materials, because of increasing delays in the delivery of German goods as a result of the pressure of home orders, and because of a general political desire in certain quarters not to purchase German goods.

In the case of her trade with countries with free-exchange systems, Germany has undertaken a number of measures to subsidise at various rates those exports which could not otherwise be effected. This is done either by varying degrees of direct subsidisation or by depreciating to a varying extent the cost of the mark in terms of foreign currencies for certain export transactions.

The turnover of industrial undertakings is subjected to a levy, the height of which is not published, in order to raise funds for the direct subsidisation of exports. The prices of German bonds are considerably higher inside Germany than in foreign markets, where the receipt of interest from them is restricted by the German foreign-exchange control; and the resulting profit obtainable from the repatriation of Germany's external debt has been used to subsidise exports. Various "blocked marks", representing, for example, sums due to external debtors, may, on certain conditions, be exchanged into foreign currencies at a value considerably below the official value of the mark; and the profit which accrues to the monetary authorities from the purchase of foreign exchange with marks at their full

¹ Cf. *Commerce Reports*, April 29th, 1939, page 408.

official value and its sale for "blocked" marks of various degrees of depreciation is also used for the subsidisation of particular exports.

In addition to the use of direct subsidies and depreciated marks, certain other less important methods have been adopted for the stimulation of export trade with the countries with free currencies. In April 1939, certain additional facilities were granted by the Reichsbank to exporters. Arrangements were made for the discount of export bills at lower rates of interest; the period of currency of bills which may be discounted with the Reichsbank was prolonged, so that export bills providing relatively long credits could be financed by the Reichsbank; new measures were taken to increase the ease with which exporters could insure against exchange risks; and the German stamp duty on bills drawn in foreign currencies was suppressed.

From the point of view of the total volume of exports in all world markets, the German trade drive does not appear to have been as successful as the more liberal methods adopted by such countries as the United Kingdom and the United States of America. As the following figures show, in

Quantum of Exports of Various Countries in 1938.

	1929 = 100	1932 = 100
Germany	71	116
United Kingdom	74	117
United States	79	152

1938, the quantum of German exports was lower in relation both to the 1929 level and to the 1932 level than in the case of the United Kingdom or the United States. In fact, the German trade drive has achieved a remarkable success in certain limited regions, where foreign exchanges are controlled and where the systems of exchange clearings or of "Aski" mark transactions, to which reference will be made later, can be extensively used. In particular, German trade has advanced rapidly with the countries of South-Eastern Europe and with certain countries of Latin America, such as Brazil, Chile and Peru; and the figures which have already been given on page 186, show how the importance of these regions as markets and sources of German trade has increased since 1929.

The reverse side of this picture is shown by the figures on page 202. The trade of certain of the countries of South-Eastern Europe with Germany, as a result both of the German trade drive and of the territorial expansion of the Reich, has expanded so greatly as to absorb almost one-half of their total trade; and

for Bulgaria the proportion is now greater than one-half. The German objective is to cultivate this region as a special source of supply for the raw materials and foodstuffs which she needs, and to pay for these products by exporting her manufactures. The economic agreement reached by Germany with Roumania in March 1939, which was stated by the German Minister of Economics to be a general model for future agreements, illustrates the type of economic relations which are being developed. Roumania agreed to increase and to orientate her agricultural production, especially towards commodities such as fodder and oleaginous and textile plants, of which Germany is in need, and Roumanian forestry was to be developed. Germany, in return, was to deliver machinery and armaments, and mixed German and Roumanian concerns were to be set up for the exploitation of Roumanian petroleum and metals.

The various methods which Germany has used to extend her trade with these countries have been based upon the existence of exchange control. With the countries of South-Eastern Europe, Germany has clearing agreements; and she was thus able to purchase freely the primary products of these countries without placing any strain on her foreign-exchange position. For, in the event of an excess of German purchases, the exporters of South-Eastern Europe accumulated frozen balances of marks due to them in the clearing; and they could not obtain payment in their own currency until greater sums of their currency were paid into the clearing in the purchase of increased imports of German goods. In certain cases, Germany, having purchased primary products in the clearing, sold some part of these goods for free exchange in other markets. But Turkey and Greece, for example, have inserted clauses in their agreements with Germany, which forbid this practice.

In the early years of these clearing agreements, there was a large accumulation of frozen debts owed by Germany; but there is evidence that these balances have subsequently been reduced.¹ In order to reduce these debts, however, the countries of South-Eastern Europe have been obliged to increase their purchases of German products, often at the expense of similar or competing products of other countries.

Much the same method has been adopted by Germany for the expansion of trade in Latin America. The German importer pays the Latin-American exporter with "Aski" marks, which can be used only for the finance of German exports to the country from which Germany has imported. These "Aski" marks are sold by the Latin-American exporter at a value which is

Cf. The Economist, December 3rd, 1938, page 485.

Share of Germany, Austria and Czecho-Slovakia in the Trade of Certain Countries of South-Eastern Europe and Latin America.

	Imports from Germany ^a as a percentage of total imports		Imports from Germany, Austria and Czecho- Slovakia as a percentage of total imports
	1929	1938	1938
Bulgaria	22	52°	58
Greece	9	29	32
Yugoslavia	16	32.5	50
Turkey	15	47	51
Hungary ^b	20	30	48
Roumania	24	37°	50
Brazil	13	25	26
Chile	15.5	26	26
Peru	10	20	21.5

	Exports to Germany ^a as a percentage of total exports		Exports to Germany, Austria and Czecho- Slovakia as a percentage of total exports
	1929	1938	1938
Bulgaria	30	59°	63.5
Greece	23	38.5	43
Yugoslavia	8.5	36	50
Turkey	13	43	47.5
Hungary ^b	12	28	50
Roumania	28	26.5°	36
Brazil	9	19	20
Chile	9	10	11
Peru	6	10.5	11

^a Excluding Austria and the Sudetenland.

^b Excluding free ports.

^c Including trade with Austria.

sufficiently depreciated to give the importer an inducement to purchase German goods. By this system also, Germany could import freely from these countries, and an excess of imports would lead only to an accumulation of "Aski" marks which could be reduced only by increased purchases of German goods by the country in question.

A number of countries have, however, restricted their exports to Germany from time to time as an alternative method of preventing the accumulation of frozen balances of marks.

Thus Brazil prevented the export of coffee, cotton and cocoa against "Aski" marks after September 1938 until February 1939. In Poland, in May 1939, a semi-official warning was issued against excessive exports to Germany. In Yugoslavia, copper may only be exported against payment in free exchange, and, in the last quarter of 1938, exports to Germany were directly restricted. Bulgaria forbids the export of wheat to countries with which she has clearing arrangements, in order to obtain free foreign exchange from its sale. Until 1938, Roumania limited the quantity of her oil sold to Germany to 25% of her total exports to Germany, and until the record harvest of 1938 she restricted her exports of wheat to Germany.

In order to preserve her trade with free-exchange countries, Roumania pays direct subsidies from the State budget on exports of wheat, timber and cattle to such countries; and these subsidies are also payable in the case of exports to countries with exchange restrictions, if payment is made in free currencies.

In order to extend her trading relations, Germany has granted credits to various countries. Thus, in October 1938, a credit of 150 million marks was extended to Turkey for the development of her industries and armaments, to be repaid by German purchases of Turkish primary products. In the same month, it was announced that Germany had granted Poland a credit of 120 million zloty for the development of Polish equipment and machinery, to be repaid with Polish raw materials, wood and agricultural products. Early in 1939, it was reported that Bolivia had received a credit of 4 million marks for the purchase of material for oilfields, 70% of which was to be repaid in petroleum and 30% in minerals and other products.

Not only have large Government credits been granted in cases such as these, but individual German exporters have also been willing to extend long credits to their customers in countries with clearing agreements. In some cases, the working of the clearing agreement has in fact shifted the burden of these credits upon the exporter or the central bank of the country to whose importers the credit has been granted. For the postponement of payments by the importers has sometimes caused a lack of funds in the clearing for the payment of the country's exporters, who have either been obliged to wait or have received advances from their central bank. Even if imports and exports with Germany are equal in value, a frozen balance of German indebtedness will accumulate if the importers of the German goods are permitted to postpone payment. To prevent this, it was provided in the Yugoslav clearing agreement with Germany towards the end of 1938 that German purchases of

Yugoslav goods were to be limited to the amount actually collected in payment from Yugoslav importers of German goods.

The agricultural export trade of the countries of South-Eastern Europe has been attracted to the German market by the fact that Germany offers prices higher than those ruling in the free world market. To some extent, this is due to existing currency relations. When the pound and other free currencies were depreciated in gold value, the German mark and the currencies of the countries of South-Eastern Europe were maintained at their official gold parity. This lowered the prices, in terms of their local currencies, which the exporters of products from South-Eastern Europe could obtain in the United Kingdom and other free-exchange countries, and, for this reason, their exports were attracted to the German market. In order to offset this tendency, the countries of South-Eastern Europe have attempted to depreciate their currencies in terms of the free currencies while maintaining the value of their currencies in terms of the mark. In Roumania, for example, a 38% premium is officially paid in terms of Roumanian lei for free foreign exchange. Yet, in spite of this, Germany continues to offer higher prices for the export products of these countries. Price discrepancies can be adjusted within Germany by such devices as levying lower rates of taxation on wheat and petrol imported from Roumania than on similar goods imported from other sources.

Since Germany wishes to attract the exports of the countries of South-Eastern Europe, it has been her policy to fix as high a value of the mark as possible in terms of the currencies of these countries in the various clearing agreements. But, on the other hand, these countries, in order to prevent the accumulation of a large frozen balance of German indebtedness in the clearing and in order to discourage the sale of too high a proportion of their exports to countries with controlled exchanges, have resisted the raising of the value of the mark in the clearing agreement. In negotiations in the autumn of 1938, the German mark was revalued at between 40.5 and 41.5 instead of between 38 and 39 Roumanian lei, but the Roumanian negotiators opposed the raising of the rate to a higher figure. In Yugoslavia, the dinar was fixed at an exchange value of 14.30 dinars to the German mark in October 1938; but, at this rate, a frozen balance of German indebtedness accumulated and the exchange value of the mark was allowed to fall to 13.80 dinars.

The overvaluation of the mark in the clearing agreements and the corresponding undervaluation of their currencies have attracted the exports of the countries of South-Eastern Europe

to Germany, and, in consequence, some of these countries have been obliged to reduce the value of their currencies in terms of the pound and other free currencies, in order to retain their export markets in the free-exchange countries. For example, in a new payments agreement concluded with the United Kingdom in September 1938, Roumanian exporters were enabled to sell 60% of their sterling proceeds at the depreciated market value of the lei for the purpose of financing payments to the United Kingdom for commodity purchases and for payment of financial debt. In August 1938, private compensation deals were authorised by the Roumanian authorities on a much wider list of commodities, and this also allowed the Roumanian lei to be depreciated in terms of free currencies, since the rate of exchange is open to free negotiation for compensation trading.¹

In Yugoslavia also, measures have been taken, the effect of which is to depreciate the dinar in terms of the pound sterling. Up to December 1938, the dinar was pegged at 238 to the pound; but since that date 50% of the sterling proceeds of exports may be sold at 262.60 dinars to the pound, and exporters of turkeys to the British market have been even more favoured by being permitted to sell their sterling receipts at an even higher price in dinars.

Germany has also adopted a number of other methods of bilateral trading. By means of a payments agreement with South Africa, Germany was to spend £6.4 million on South-African exports in 1938 and, of this sum, nearly £4 million were allotted to the purchase of South-African wool, the total exports of which were approximately £9 million. Germany has recently also concluded some large-scale barter transactions. For example, in March 1939, she bartered 14 million pesos worth of railway equipment for Argentine wheat worth 6 million pesos and wool worth 8 million pesos.

Italy has also adopted similar measures to promote her trade with various countries. For example, two barter deals have recently been arranged with Mexico — the first for \$3 million worth of Mexican oil against three tankers to be built in Italy, and the second for \$2.5 million worth of oil against Italian machinery and artificial silk. But the most significant development in the Italian trade policy was the decision to form a series of monopolistic trading companies for the purchase of imports. Such institutions, which have already been set up for the purchase of coffee, groceries, spices, fish and lumber, would take

¹ This same type of policy has also been adopted by other countries. Thus, in April 1939, the system of private compensation trading was introduced into the existing commercial agreement between Poland and France; and this change will permit the depreciation of the zloty below the official gold parity for such trading with France.

advantage of the bargaining-power obtained from a central monopoly of purchases, and would distribute the imports among the internal purchasers. It is, moreover, intended that these import institutions should stimulate the Italian export trade by linking their imports with Italian exports to a certain extent.

Chapter IX.

THE ECONOMIC EFFECTS OF WAR,
REARMAMENT AND TERRITORIAL CHANGES

During the period covered by this *Survey*, political events have exercised an increasingly important influence upon economic developments. International tension has greatly increased the risks and uncertainties of economic activity. This loss of confidence has restricted private capital development for peaceful purposes and has greatly stimulated public expenditure on national defence in the majority of countries. Another effect of this lack of confidence has already been examined in Chapter VII, where figures were given to illustrate the flow of capital from Europe to the United States in search of safety. In recent months, central banks and other monetary authorities in various countries have themselves removed their reserves of gold for safety to the United States and to other countries, and this development is illustrated by the following figures of earmarked gold:

	Gold earmarked for foreign account in *				
	United States	Canada	South Africa	British India	Total: four countries
	\$ (000,000's)				
April 1938	316	81	—	—	397
March 1939	652	155	204	36	1,047
June 1939	1,095	...	...	...	...

* Cf. *Federal Reserve Bulletin*, July 1939.

A further example of the economic disturbances caused by political tension is provided by the sudden increase in the demand for cash, which occurred in many countries during the

crisis of September 1938 and to which reference has been made in Chapter III (page 86).

Lack of confidence has, however, been only one of the many ways in which political events have influenced economic activity in recent months. In Spain and in China, war itself has been the cause of great economic destruction. Territorial changes have modified the internal economic problems of Germany and the international economic relations of many other European States. As has been seen in Chapter II, increases of expenditure on national defence, unprecedented in times of peace, have profoundly changed the economic situation in a number of countries; these developments towards a war economy have necessitated a widespread increase of Government control over production, consumption, prices, wages and hours of work. Moreover, commercial policy has been increasingly influenced by the desire to increase self-sufficiency in anticipation of war and by various other non-commercial motives; and a number of the developments recorded in the preceding chapter have been affected by such considerations.

As has been seen in Chapter IV (pages 107 and 108), and in Chapter VIII (pages 185 to 187), this growth of economic nationalism has caused a progressive disintegration of the world economy.

THE ECONOMIC EFFECTS OF WARFARE

After two and a half years, the Spanish civil war came to an end in April 1939. As the following figures show, the war has practically halved the value of Spanish foreign trade:

*Value of Spanish Trade with Fourteen Countries.**

	Old U.S. gold \$ (000,000's).	
	1935	1938
Spanish imports	116.5	64
„ exports	115.—	61

* Figures according to the trade statistics of the fourteen countries: the United States of America, the Argentine, Belgium, the United Kingdom, Egypt, France, Germany, India, Italy, the Netherlands, Portugal, Sweden, Switzerland and the Union of Soviet Socialist Republics.

In addition, the destruction and disorganisation of war conditions have greatly reduced the level of internal productivity. The decline in crops yields, for example, has made it necessary to import substantial quantities of wheat.

*Spanish Wheat Production.*¹

Bushels (000,000's).				
1934	1935	1936	1937	1938
187	158	121.5	132*	103*

* Provisional.

It is reported² that most of the peace-time industries of Madrid have disappeared; that in the Catalan textile industry, which in 1933 represented 93% of the spindles and 82% of the looms in Spain, some 20% of the mills have been destroyed, while in others textile machinery has been replaced by machinery for war production; and that of the 3,000 locomotives possessed by Spain in 1936, 1,700 still exist, of which some 700 are in need of repairs.

As a result of this destruction, the power of the Spanish economy to export has been diminished, while there is a pressing need for imports for purposes of reconstruction. The consequent pressure upon the Spanish balance of foreign payments has been eased by means of rigid exchange control and by the compulsory surrender of foreign money and of foreign securities to the Bank of Spain at the official rate of exchange. As a first measure of economic reconstruction, a Credit Institute for National Reparation was set up in April 1939 to grant advances at a maximum rate of interest of 3% for the restoration of war damage.

In China also, great economic destruction has been caused by warfare. Property has been destroyed on a very great scale, not only by bombardment and direct military operations, but also by the Chinese "scorched earth" policy, by Japanese reprisals against the activities of guerilla troops, and by floods in North China and in the provinces bordering the Yangtse and the Yellow rivers. In and around Shanghai, from 30% to 100% of Chinese industrial establishments have been destroyed, according to the district affected; in Canton, industrial plants, water and electricity works, the general Post Office and most of the city's modern business sections have been almost entirely destroyed by fire; and of foreign investments in China valued at the start of the war at \$3,500 million (United States dollars), some \$800 million are claimed to have been irrevocably lost, American losses up to July 1938 being assessed at \$200 million, British losses at \$400 million and German losses at "equally impressive figures".³

¹ Cf. *Wheat Studies of the Food Research Institute*, Stanford University, December 1938, page 238.

² Cf. *Economist*, June 24th, 1939.

³ Cf. *Chinese Maritime Customs: The Trade of China, 1938*, Introductory Survey.

But direct destruction of property is not the only economic damage occasioned by the war. For example, in the districts occupied by the Japanese, it is reported that foodstuffs, pack animals and blankets have been requisitioned by the troops, and wooden possessions — such as doors, tables and chairs — have been removed for fuel and other military uses. Similarly, farm implements have been destroyed in order to use the wood and the metal. Land and labour have been conscripted for military purposes. Great economic distress has been caused both by the general breakdown of local administration in the country districts occupied by the Japanese and also by the colossal refugee problem to which the war has given rise.¹ Economic life has been further disorganised by the blockade of the Chinese coast and the closing of the Yangtse river to traffic.

In an attempt to reorganise the economic basis of the defence of China, much valuable industrial capital equipment has been moved westward with Government aid to zones of comparative safety; and a new Ministry of Economics and a National Resources Committee have been set up. Moreover, an Industrial Mobilisation Bill has been promulgated to give the Chinese Government control over a large number of branches of economic enterprise.

Since 1936, Chinese exports have fallen considerably, but there has been a surprisingly small fall in Chinese imports; but

Value of Chinese Foreign Trade.

U.S. old gold dollars (000,000's).

	Chinese imports		Chinese exports	
	1936	1938	1936	1938
Chinese trade with:				
Japan	26.9	35.9	17.9	13.8
United Kingdom . .	19.4	12.2	11.4	6.7
Germany	26.3	19.6	6.9	6.7
United States	32.5	26.2	22.7	10.3
All countries	165.5	154.2	124.2	90.6

while imports from Japan have increased considerably — mainly through the channel of the ports occupied by the Japanese — imports from certain other countries, such as the United Kingdom, Germany and the United States, have fallen sharply.

¹ *Cl. Far-Eastern Survey*, March 15th, 1939.

As a result of the successive occupation of the Chinese ports by the Japanese, the proportion of Chinese imports passing through ports occupied by the Japanese rose from 35% to 90% between January and December 1938.¹ One result of this development was the declaration in January 1939 by the Chinese Government of its inability to continue payments of the service on its foreign loans secured on the maritime Customs. An agreement of May 1938 between Japan and the United Kingdom for the payment of contributions towards the services of these loans from the Customs revenue raised in ports occupied by the Japanese has remained inoperative. In view of the increased control of the Japanese over the maritime Customs, the revenue of the Chinese Government has become inadequate for the maintenance of the service on the foreign loans, although in 1938 the Chinese Government paid the necessary sums from its other sources of revenue.

The Japanese have taken various measures to organise the economy of the districts which they have occupied. With the object of ensuring the long-term economic development of these areas by Japanese capital, the North China Development Company and the China Promoting Company have been founded. But the immediate problem has been the organisation of new currencies for the occupied areas. At first, the Japanese armies put special yen notes into circulation to finance their purchases in the occupied areas; but in March 1938, a Federal Reserve Bank was founded, the notes of which were to become the legal tender for North China at par with the Japanese yen. These new notes, however, fell to a discount with the notes of the Chinese Government, as a result of passive resistance on the part of the Chinese in the occupied territories and because the notes of the Chinese Government were at first exchangeable into foreign exchange, whereas the new Federal Reserve Bank notes were convertible only into yen, which in turn was subject to a strict exchange control.

It has been estimated that some \$200 million of the new reserve notes have been put into circulation; but of this sum, only \$15 million have been issued in exchange for the withdrawal of the Chinese Government notes, the remainder being disbursed for payments by the Japanese. Some \$300 to \$450 million of Chinese Government notes are estimated to be still in circulation in the region.² The Japanese were at first able to obtain foreign exchange from the Chinese in redemption of Chinese Government notes obtained from the issue of the new

¹ Chinese Maritime Customs: *op. cit.*

² Cf. *Oriental Economist*, May 1939.

Federal Reserve notes; but in March 1938, largely to prevent this, the Chinese introduced a system of exchange control and at the same time reduced the exchange value of the Chinese dollar from 1s. 2d. to 8d.

This depreciation of the Chinese currency made it cheaper for foreign buyers to purchase Chinese goods by means of the Chinese Government currency; and for this reason, foreign exchange reserves were diverted from the new Federal Reserve Bank. But, in March 1939, the Japanese authorities instituted a system of exchange control to prevent the export of certain goods from North China unless the foreign exchange proceeds were paid into the Federal Reserve Bank in exchange for the new currency at the par rate of 1s. 2d.; and, in July 1939, this exchange control was extended to cover practically all exports.

In May 1939, it was decided to set up a new bank — the Hua Hsing Bank — to issue notes to replace the Chinese currency in the districts of Central China which were occupied by the Japanese; but in this case, the new notes were to be pegged to the Chinese dollar and not to the Japanese yen.

The Chinese dollar has been supported to a certain extent by the agreement of the United States to purchase Chinese silver, by the credit of \$25 million (United States dollars) granted by the Import-Export Bank of the United States¹ and by the formation in March 1939 of an exchange stabilisation fund of £10 million, half of which was guaranteed by the British Government.² But pressure on the Chinese dollar has caused a severe depreciation of the currency from 8d. to 6½d. in June and to 4½d. in July 1939. Various factors, such as an export of capital, the need for essential imports to prosecute the war, and the increasing control of the Japanese over the ports and so over the finance of Chinese exports, have intensified this pressure; and the reduction in the price paid for foreign silver by the United States from 43 cents in June to 35 cents an ounce in July 1939 has reduced the supplies of foreign exchange which can be obtained from the sale of Chinese silver. In June 1939, the Chinese Government adopted further measures of exchange control to prevent the export of private capital and to ensure that the foreign exchange proceeds from exports were turned over to the Chinese Government; and, in July 1939, foreign exchange dealings were still further restricted, and a ban was placed upon the import of luxury goods.

As a result of the action taken by the Japanese authorities in the occupied areas of China, the Government of the United

¹ Cf. Chapter VIII, page 192.

² Cf. Chapter VIII, page 191.

States, in October 1938, protested against breaches of the pledge to maintain the open-door principle in China. Reference was made to the exchange control which had been instituted in North China, to the alterations in the Customs tariff introduced by the authorities under Japanese control, to the establishment of special companies under Japanese control with monopoly privileges, such as the China Telephone and Telegraph Company, to the organisation of a Japanese company to operate wharves at Tsingtao which were previously publicly owned, and to the exclusion of American and other non-Japanese shipping from the lower Yangtse river. In July 1939, the American Government denounced its commercial treaty with Japan, which guaranteed most-favoured-nation treatment to Japanese commerce.

In Japan itself, the war has led to a considerable fall in the standard of living. Some indication of this has already been given in the graph on page 39 of Chapter I, which shows how the production of consumption goods has been restricted in order to allow an increase in the production of investment

Japan: Net Value of Production.

	Total production	Total production, less the direct war demand for goods	
		At current prices	At 1936/37 prices
		Yen (000,000,000's)	
1936/37 . .	12.0	12.0	12.0
1938/39 . .	16.5	12.7	10.0

goods, which include the instruments of war. This development is typified by the fact that, between January 1938 and January 1939, the production of iron, steel and machinery increased by 21%, while the production of textile goods fell by 13%.¹ It has been estimated² that industrial production for civil purposes has been reduced by more than a third as a result of the increased production of both arms and munitions and also of capital equipment for the production of arms and munitions. Consumption has not, however, fallen by as large a proportion as this; for agriculture, forestry and fishing, which make up a very large part of Japanese consumption, have been relatively little affected. But, as the figures² above show, total production,

¹ Cf. *Mitsubishi Monthly Circular*, June 1939, page 1.

² Cf. *Wochenbericht des Instituts für Konjunkturforschung*, Berlin, June 28th, 1939.

after deducting production for direct war purposes and after making allowances for changes in prices, fell by about a sixth between 1936/37 and 1938/39.¹

The standard of living in Japan has suffered, not only because of the fall of internal production for civil purposes, but also because of the increased difficulty of importation. As the following figures² show, the value of Japanese imports, other than those of direct military importance, fell by about a third between 1936 and 1938:

Value of Japanese Imports.

	Yen (000,000's).	
	1936	1938
Total imports	2,764	2,663
<i>Of which:</i>		
Imports of direct military importance	660	1,247
Other imports	2,104	1,416

As has already been seen in various chapters of this *Survey*³ the organisation of the war economy in Japan has involved a great extension of Government control over the national economy. Through the control of imports and of internal supplies, raw materials are rationed with a priority for war purposes. For example, rationing by means of quotas for consumption has recently been started in the case of coal. The existing control over capital extensions, which gave preference to extensions for war purposes, has been strengthened by the Capital Employment (Amendment) Act, which entails the absolute control over the creation of any new enterprise. The scope of existing Government control is illustrated by the present position of the textile industry. In the autumn of 1937, the expansion of the textile industry was virtually prohibited by Acts restricting the import of raw materials and limiting the use of funds for capital extensions. In the summer of 1938, the use of raw cotton for domestic production was severely restricted; and the import of raw cotton has been linked to the export of cotton products. In January 1939, a Textile Distribution Council was set up to determine the production plans and consumption quotas for cotton yarn, staple fibre, staple fibre yarn, rayon and woollen yarn.

¹ The fall would be larger if allowance could be made, not only for direct production for the war (arms, munitions, etc.), but also for production of capital equipment for the manufacture of arms and munitions.

² Cf. Institut für Konjunkturforschung, *loc. cit.*

³ Cf. Chapter I, pages 37-41, and Chapter V, pages 132-133.

In addition, the labour market has been organised to guide labour into the channels necessary for the war economy. Wages, profits and prices have all been subjected to public control, to prevent the expansive methods of Government finance from leading to a progressive inflation of incomes, prices and costs. In May 1939, the Government announced its approval of the report of the Central Committee on Price Control, which had outlined various ways in which the existing controls should be extended in order to reduce the rate at which prices were rising. It was suggested that cost accounting principles should be adopted for the fixation of official maximum prices; that price rises should be reduced through the closer adjustment of supply and demand for particular products by such means as the increased use of substitutes and waste products, the restriction of production of inessential commodities, increased production through rationalisation, and the restriction of consumption of inessential commodities through rationing and the control of distribution; that monetary purchasing power should be absorbed by such means as increased savings and taxation; and that freight charges, profits, rents and wages should be controlled and reduced.

As has already been seen,¹ largely as a result of the war, the Japanese balance of trade with countries outside the "yen bloc" has deteriorated, and this has led to a considerable export of gold, as the following figures* show:

Japanese Balance of Trade and Gold Exports

	Value of excess of Japanese exports (+) or of Japanese imports (—) in trade with		Gold exports
	"Yen bloc"	Other countries	
	Yen (000,000's)		
1936.	+ 263	— 334	—
1937.	+ 353	— 961	858
1938.	+ 602	— 575	593

Exports have been reduced, partly as a result of foreign boycotts and partly because of the scarcity of materials and the rise of internal prices and costs which have resulted from the internal competition of war demands. At the same time,

¹ Cf. Chapter VII.
^{*} Cf. Institut für Konjunkturforschung, *loc. cit.*

the war has increased the need for various imported raw materials. To meet this situation, severe measures of import restriction and of exchange control have been adopted, and as far as possible home-produced substitutes are being developed to take the place of imported materials.¹

The ECONOMIC EFFECTS OF TERRITORIAL CHANGES

Territorial changes in Europe in the course of 1938 and 1939 have affected a number of countries; but their economic effects have been of major importance in relatively few cases. The occupation of Albania by Italy in April 1939, for example, brought with it little economic change, partly because of the comparatively unimportant contribution of Albanian resources to the Italian economy, but more particularly because many branches of Albanian economic activity — including the production of Albanian oil — were already controlled by Italy. The districts annexed by Poland from Czecho-Slovakia in October 1938 were small in area but were highly industrialised; and, as the following figures show, they have an appreciable effect upon the Polish resources of coal and steel. Other industries operating in the annexed territory include machinery,

Poland: Production of Coal and Steel.

	Coal	Steel
	Metric tons (000,000's)	
Poland (1937)	36.2	1.5
Districts of Czecho-Slovakia annexed by Poland	7.5 ^a	0.7 ^a

^a Figures from official announcement, reported in *The Times*, October 5th, 1938.

chemicals, textiles, timber and building. Carpathian Ruthenia, occupied by Hungary in March 1939, is one of the richest forest areas in Europe. Hungary will, in consequence, diminish her imports of timber and will acquire a surplus of fine timber for export. Ruthenian mines will provide for Hungary's total consumption of salt.

The territory of the German Reich has been increased by the occupation of Austria in March 1938, of the Sudeten districts of Czecho-Slovakia in October 1938 and of the rest of the Czech provinces of Czecho-Slovakia in March 1939; and those changes have had important effects upon the German economy. In the first place, Germany acquired significant

¹ Thus it is reported (*Far-Eastern Review*, April 1938) that commodities made of metal, leather, rubber and other materials needed for the war are being replaced by substitute goods.

stocks of gold and foreign assets. The reserves of gold and foreign assets of the Austrian National Bank were worth approximately RM248 million; and those of the National Bank of Czecho-Slovakia were worth approximately RM296 million, at the beginning of March 1939.¹ There were, in addition, unspecified amounts of private holdings of foreign balances and foreign securities which could be mobilised by the German Government. It is, however, uncertain to what extent the German Government has been able to utilise the Czecho-Slovak assets. For immediately after the German occupation of Bohemia and Moravia, the British and French Governments placed embargoes upon the payment of Czecho-Slovak assets held in London and Paris, and the Government of the United States requested the American banks to refrain from making any unusual transfers of Czecho-Slovak credits.² For example, of the reserves of the National Bank of Czecho-Slovakia, valued at RM296 million, some RM90 million represented foreign exchange as opposed to gold holdings; and practically the whole of this sum represented the unexpended balance of the British credit of £10 million granted to Czecho-Slovakia in October 1938, which was blocked by the British embargo.

Certain sums of the reserves of the National Bank of Czecho-Slovakia are known to have accrued to the German authorities. In the first place, immediately before the German occupation of Bohemia and Moravia, the National Bank of Czecho-Slovakia surrendered some 466 million Kč of gold to Germany as representing the gold cover of the Czecho-Slovak notes withdrawn from the Sudeten districts. Secondly, in May 1939, the Swiss National Bank, in execution of an order of the National Bank of Prague, transferred some 366 million Kč of gold to the German authorities; and thirdly, in May and June, gold valued at some £10 million was transferred by the Bank for International Settlements to the German monetary authorities. These three sums together amount to some RM189 million.

Austria and Czecho-Slovakia were both highly industrialised; and they were not, therefore, complementary to the industrialised German economy. Both, as in the case of Germany, lacked

¹ These figures are large in comparison to the published reserves of gold and foreign exchange held by the Reichsbank, valued at RM77 million at the end of 1938; but they are small in comparison with Germany's requirements for the financing of imports, which amounted to RM5,449 million for the old territory of the Reich during 1938. It appears that a large part of the Austrian reserves was required to finance an import surplus of RM192 million in the course of 1938.

² It has been officially stated that the British embargo covered some £16 million of Czecho-Slovak assets (including private holdings as well as assets of the National Bank of Czecho-Slovakia), and that there were British claims of some £15 million to set off against these assets.

such raw materials as rubber, wool, cotton, various non-ferrous metals, fats and oil. In agricultural production, Austria was more dependent than Germany upon imports of cereals, but she produced a surplus of dairy produce which could relieve in some measure the German lack of such products.¹ Czecho-Slovakia, on the other hand, had a small export surplus of cereals and a large export surplus of beet sugar and hops; but she was dependent upon outside supplies of certain important foodstuffs, such as pigs and vegetable oils.

Austrian timber, iron ore and certain ferro-alloys such as manganese, magnesite and graphite also made an important contribution to Germany's policy of self-sufficiency. In 1937, Austrian timber exports to countries other than Germany represented 54.5% of Germany's imports from countries other than Austria, but the corresponding percentage in the case of Austrian exports of iron ore was less than 1%.² Both the Sudeten districts and the rest of the provinces of Bohemia and Moravia were important sources of supply of timber, which is becoming increasingly important in Germany as a means of producing substitute raw materials for the textile industry. As the following figures show, the occupation of Czecho-Slovakia has appreciably increased the German resources in lignite, coal, pig-iron and steel.

Production of Lignite, Coal, Pig-iron and Steel, 1937.

Metric tons (000,000's).

	Lignite	Coal	Pig-iron	Steel
Former Germany	184.8	184.5	16.0	19.8
Austria	3.2	0.2	0.4	0.7
Bohemia and Moravia (including Sudeten districts)	17.2	9.3	1.2	1.8

Although Germany already had an export surplus of coal, the increased resources in lignite and coal were of great importance, for exports of coal were necessary to obtain supplies of foreign exchange, while the internal demand was greatly swollen by the use of coal to produce artificial rubber, oil and chemicals, as well as for the general uses of industry; and increasing difficulties were being encountered in increasing the home production.

¹ Cf. League of Nations: *World Economic Survey, 1937/38*, page 184. In 1937, Austrian exports of butter and cheese to countries other than Germany represented 19% of Germany's imports of these products from countries other than Austria.

² Cf. League of Nations: *World Economic Survey, 1937/38*, loc. cit.

As the table on page 218 shows, production of pig-iron and steel in Bohemia and Moravia has considerably increased the German industrial capacity. Bohemia and Moravia, like Austria, were highly industrialised; and while the Sudeten districts concentrated largely on the production of consumption goods, such as textiles and glass products, for the export market, the rest of Bohemia and Moravia contained important heavy industries devoted to the production of capital goods and of armaments. But, as in the case of Germany, such production was based largely upon the import of iron ore; for the former Czecho-Slovakia provided about 58% of her own requirements of iron ore and imported the remainder mainly from Sweden. It has been estimated that, at the beginning of 1939, the industrial production of the former German Reich represented 13.3% of world industrial production, and that this figure has been raised to 15% by the inclusion of Austria and Bohemia and Moravia.¹

Both Austria and Bohemia and Moravia possessed unused resources of labour and capital, whereas Germany has for some time suffered from a severe shortage of such resources. These territorial changes therefore provide an important opportunity to Germany to develop still further the production which is required for her policy of rearmament and selfsufficiency. Thus, the number of registered unemployed in Austria fell from 351,000 to 59,000 between May 1938 and May 1939; and between the first quarters of 1938 and of 1939 the Austrian production of pig-iron rose by 84% and of crude steel by 70%.² In Bohemia and Moravia, an important reserve of labour existed in the form of unemployed workers and of workers on short time, and these reserves will be increased by the disbanding of the Czecho-Slovak army. In May 1939, for example, it was announced that 25,000 Czech workmen had been transferred to Germany.

As has already been seen in Chapter VIII (*cf.* page 202), the territorial expansion of Germany has greatly affected the trading relations of various countries of South-Eastern Europe. The proportion, for example, of the foreign trade of Yugoslavia which is conducted with Germany has been raised by the territorial changes from about a third to approximately half. In the same way, these changes have led to a considerable concentration of the investments of foreign capital in certain countries of South-Eastern Europe; and, as the following figures show, the proportion of the foreign capital invested in

¹ Cf. *Reichskreditgesellschaft*: "Deutschlands Wirtschaftliche Lage in der Jahresmitte, 1939".

² *Wochenbericht des Instituts für Konjunkturforschung*; Berlin, May 24th, 1939.

Yugoslavia which is in the control of Germany has been very greatly increased.

*Investment of Foreign Capital in Yugoslavia.*¹

Dinars (000,000's).

Czecho-Slovakia	741
Austria	366
Germany.	55
Total of above	<u>1,162</u>
France.	1,056
United Kingdom	874

ECONOMIC ORGANISATION FOR NATIONAL DEFENCE

The organisation and control of the economic system for the production of armaments, for the increase of self-sufficiency and for industrial mobilisation in case of war has probably gone further in Germany than in any other country. The economic organisation which has been adopted has been described in broad outline in previous sections of this *Survey*.² Large sums are spent by the State on rearmament and on public investment for self-sufficiency and other purposes. These sums are financed by expansive financial means, in spite of the full employment of the available economic resources; but a strict control of prices, wages and of the distribution of profits is combined with heavy taxation and a savings campaign to prevent excessive expenditure. At the same time, labour, capital, raw materials and the available foreign exchange are rationed in such a way as to give preference to agricultural production and production for armaments, substitute raw materials, and export, over production for other purposes.

In the period covered by this *Survey*, this system has not been fundamentally altered, but has been developed in certain respects. The new plan for the finance of public expenditure has already been outlined in Chapters I and II; and, in Chapter V, reference has been made to a number of recent measures designed to meet the growing scarcity of labour. Various measures have been taken to increase productivity. For example, commissioners with full powers of control have been appointed to supervise the building industry, the machine

¹ Cf. *Service économique Yougoslave*, April 15th, 1939.

² Cf. Chapter I, pages 31-37; Chapter III, pages 99 and 100; Chapter V, pages 129-131; and Chapter VIII, pages 199-206.

industry, the motor industry and the power industry. It is their task to ensure that these industries are rationalised as effectively as possible and to distribute the limited production possibilities on an emergency scale which will give priority to the State requirements and to the needs of the Four-Year Plan and of the export markets.¹ In May 1939, a new principle was adopted for the fixation of wage rates, one of the main objects of which was to increase output. According to this principle, normal wages will be rigidly fixed, and any increase in earnings will be made strictly conditional upon a higher output of the individual worker.

Considerable changes in the economic preparation for national defence have occurred in the United Kingdom and in France during the period covered by this *Survey*. In the United Kingdom, expenditure on national defence has risen with great rapidity. In 1938/39, such expenditure amounted to £400 million. In April 1939, a budget estimate of £580 million was announced for 1939/40, but this figure was raised almost immediately to £630 million; and in July 1939, a further increase to £730 million was announced. This last figure is more than six times the level of expenditure on national defence in 1934/35, and as much as £500 million of this sum is to be raised by means of borrowing. This most recent increase in the level of borrowing and of expenditure for national defence has intensified the problem of avoiding a scarcity of labour resources, to which reference has been made in Chapter I (pages 25 and 26) and Chapter V (page 132).² Further claims upon the existing resources of labour have been made by the expansion of the regular armed forces, and by the introduction of a form of military conscription, which removes some 200,000 young men from the labour market for a period of six months.

In effect, these measures of rearmament have greatly stimulated activity. Steel output reached a new record level in May 1939, having risen by 86% since December 1938. Unemployment³ fell from 2,039,000 to 1,256,000 between January and July 1939, when the number of unemployed available for industrial employment was lower than at any time since November 1929; and the number of workers in registered employment rose to unprecedented levels in May, June and July 1939. At the same time, however, certain branches of economic activity which are particularly sensitive to the increased international tension have continued to decline in the United Kingdom.

¹ Cf. *Weekly Report of the German Institute for Business Research*, July 14th, 1939.

² Chapters I, II and V of this *Survey* were written on the assumption of borrowing for national defence in the United Kingdom of £380 million and of a total expenditure on national defence of £630 million in 1939/40.

³ Including registered agricultural unemployment.

For example, the value of housing plans fell by 29% between June 1938 and June 1939. The high level of economic activity which has resulted from the rearmament programme has, moreover, been accompanied by no appreciable rise in the prices of securities or of commodities. Security prices were depressed partly as a result of the taxation of profits and of the possibility of increased costs of labour and raw materials. In addition political uncertainty, combined with the failure of American economic recovery to develop during the first half of 1939, has depressed all speculative markets.¹

Reference has already been made in the preceding chapter to various economic measures taken in the United Kingdom. An agreement has been reached with the United States for the barter of stocks of rubber for stocks of American cotton for the formation of an emergency war reserve.² The shipping subsidies announced in the United Kingdom³ have already had a marked effect in promoting the construction of merchant vessels in the United Kingdom. Construction had been started on only 71,000 tons of merchant shipping in the first quarter of 1939, but this figure rose to 402,000 tons in the second quarter of the year; and the total of merchant tonnage under construction rose from 597,000 to 791,000 tons in the same period. To prevent an excessive pressure upon the exchange value of the pound, certain controls over the movement of capital funds across the foreign exchanges have been reintroduced.⁴ Various loans have been made to foreign Governments for the supply of armaments.⁵

A number of additional measures have been taken to ensure the adequacy of supplies of certain economic resources in case of war. British agricultural production has been promoted in a number of ways; and certain of these measures — such as the offer of a subsidy for each acre of land ploughed up before the end of September 1939, the formation of reserves of fertilisers, feeding stuffs, tractors, implements and seeds, and the enrolment of persons willing to work on land in war-time — have been specifically undertaken as for the purpose of national defence. The moderate sum of £8.5 million was spent during 1938/39 for the formation of war reserves under the Essential Commodities Reserves Act. Reference has already been made to purchases of Roumanian wheat for such reserves⁶ and, in July

¹ As a result of the general depression in commodity prices, combined with the surplus supplies to which reference has been made in Chapter IV, wheat was reported to have been sold in England in July 1939 at a price equivalent to the lowest since 1592.

² Cf. page 189.

³ Cf. page 190.

⁴ Cf. pages 196 and 197.

⁵ Cf. page 191.

⁶ Cf. Chapter VIII, page 190.

1939, it was officially announced that a further substantial addition had been made to the Government's wheat stock. Certain other reserves have been formed. The Defence Services have purchased reserves of essential materials; supplies of food are held by the Food Defence Plans Department for the immediate needs of persons to be evacuated from dangerous areas; and individuals have been advised to hold a private reserve of foodstuffs. The sum of £2.1 million has been granted for the purchase by the Government of a reserve of merchant ships; and shipowners are to offer their vessels for sale to the Government before offering them for sale abroad. Investment trusts and insurance companies have been asked to provide information about their holdings of foreign securities which could be mobilised in the event of war.

A number of steps have been taken to organise the British economy to meet the risk of war. A pool of private insurance concerns has been formed for the purpose of insuring shipping and commodities against war risks, and this pool can reinsure such risks with the State. Various plans have been announced for economic organisation in time of war, including schemes for the rationing and distribution of foodstuffs and of petrol supplies, for the regulation of the production and sale of coal, and for the organisation of the railways under Government control. An Armaments Profits Duty at an effective rate of 40% on excess profits which can be attributed to armament production has been imposed as a method of supplementing existing controls over such profits.

Towards the end of 1938, a panel of industrialists was set up to advise the Prime Minister on the industrial aspects of the rearmament programme, and to serve as a link between industry and the Service Departments. In April 1939, it was announced that a Ministry of Supply was to be formed with wide powers over industry. Such powers included the right to secure priority for Government orders, and the right to require business enterprises to produce for the State and even, if necessary, to alter their plant in a way suitable for such production; the Minister of Supply was empowered to compel available storage space to be placed at the Government's disposal and to finance the accumulation of reserves by grant or by loan; companies' books were made subject to Government inspection for the purpose of determining fair prices; and manufacturers could be compelled to take measures to protect essential parts of their plant. The immediate scope of the work of the Ministry was restricted to the provision of certain supplies for the army and of certain equipment which was used in common by a number of departments, and to the formation of certain emergency

reserves; and, in June 1939, it was announced that some £100 million would be spent by the Ministry out of a total expenditure on national defence, estimated at that time at £630 million for 1939/40. It was stated at the same time that the compulsory powers of the Ministry would be exerted only if the voluntary method proved inadequate and that special consideration would be paid to production for export.

In France, the economic changes due to the organisation of national defence have been as striking as in the United Kingdom. There has been a marked increase in economic activity in France, due partly to the rapid increase in Government expenditure upon national defence¹ and in part to the series of economic reforms initiated in the autumn of 1938.² These reforms have included a policy of cheap money and other measures to encourage private investment and also an extension of the hours of work. As the following figures show, they have resulted in a substantial increase of production in the industries most closely connected with rearmament; and, as has been seen in Chapter VII, they have been accompanied by a marked improvement both in the balance of foreign trade and in the return of exported capital.

France: Hours of Work and Production in the Heavy Industries.

	Percentage of workers working each week		
	Under 40 hours	40 hours	Over 40 hours
April 1938	20	80	—
April 1939	10	60	30

Increase of Production between May 1938 and May 1939.

General index	+ 18%	Pig-iron and ferro-alloys	+ 45%
Motor-cars	+ 15%	Steel (ingots and cast-	
Engineering	+ 22%	ings)	+ 48%
		Coal	+ 15%

¹ Cf. Chapter II, page 59 and pages 76-79.
² Cf. Chapter I, pages 26-31.

A large number of measures have been taken to reorganise the French economy to meet the risk of war. The extension of hours of work up to sixty hours in industries working for national defence and up to forty-five hours without payment for overtime in all industries has already been described.¹ The Law of August 1936 for the nationalisation of the armament industry has led, through its gradual application, to greater control of all industries working for national defence, to the nationalisation of a few concerns producing specialised arms and to the financial participation of the State in other firms. One of the main objects of this action has been the preparation for industrial mobilisation in case of war.²

Many further measures have been taken by a series of decree-laws. In March 1939, powers were taken to secure priority for Government orders; a production service was established in the Ministry of National Defence, whose duties were to include the determination of priorities for different Government orders, the formation of stocks of materials and the administration and financing of contracts; and the Treasury was authorised to advance sums to manufacturers in need of capital for production for national defence. Decrees issued in April 1939 restricted the freedom of employers in engaging the limited supplies of labour which were available, limited the height of profits obtainable from orders for armaments, and imposed a general tax of 1% on sales to help the finance of armaments. In May 1939, a credit was opened for the exploitation of abandoned mines; the military authorities were given power to requisition all forms of transport; a committee was appointed to assist in the transfer of redundant men from railways and other public services to such services as needed their labour; and a pool of private insurance companies was instituted to take over the insurance of war risks, with the prospect of State assistance in case of war.

Changes of the kind which have been outlined in the case of the United Kingdom and France have been widespread in a large number of other countries. In Chapter II (pages 58 to 61), it has been seen that expenditure on national defence has risen rapidly in many countries; but the increase has been even more widespread than is suggested by the limited number of countries examined in that chapter. Australia, for example, which spent some £A3 million on national defence in 1932, is reported to be spending some £A32 million in the course of the current year; and it has been officially announced that

¹ Cf. Chapter V, page 135.

² Cf. Paul REUTER: "La Nationalisation des Usines de Guerre", *Revue d'Economie politique*, March-April 1939.

Roumania spent as much on orders for war materials between February and June 1939 (namely, 25,000 million lei) as during the whole period from 1930 up to February 1938.¹ In Switzerland, a proposal has been adopted for the additional expenditure of about 170 million francs on national defence and about 160 million francs on public works; and this expenditure is to be financed by a continuation of the crisis tax, by a credit of some 75 million francs from the profit obtained from the devaluation of the franc in 1936 and by a new tax on large shops.² The heavy industrial investment financed by Poland in the "strategic triangle", to which reference has been made in Chapter II (pages 65 and 66), is a striking example of industrial development and reorganisation which has been largely inspired by problems of national defence.

A country which successfully maintains its neutrality during a war between neighbouring States must nevertheless face the risk of certain losses or of obstruction to its sources of supply as a result of hostilities. In Norway, a special company has been organised to take over insurance against war risks, and the help of the State is foreseen at a later stage; in Denmark, a guarantee capital fund has been formed to meet insurance against war risks, half of which has been subscribed by the State; and, in the Netherlands, private companies are enabled to reinsure war risks with the State. Similarly, various measures have been taken to increase reserves of essential commodities. Thus, in Switzerland, private householders have been instructed to store fuel and foodstuffs; and the traders which hold import permits have been required to establish certain reserves of coffee, sugar, rice and edible fats and oils, as well as of certain raw materials and semi-manufactured products. In Denmark, the Government is authorising the import of additional supplies of hops, wool yarns, chemicals and rubber. In Sweden, reserves of raw materials have been established; and the national association of retail merchants has instructed its members to advise customers on food storage.

THE POSITION OF THE UNITED STATES

Of the great industrial countries, the United States remains the least affected economically by the existing state of international political tension. Expenditure on national defence in the United States has risen significantly in the past few years; but, in relation to the national income, it still has only

¹ Cf. report of speech by the Prime Minister of Roumania, *The Times*, June 29th, 1939.

² Cf. *Economist*, July 15th, 1939, page 115.

one-tenth of the importance of expenditure on national defence in such a country as France.¹ A few measures of economic preparation have been taken in the United States. Thus Congress has voted \$100 million for the establishment of an emergency war reserve of raw materials; and reference has already been made to the barter of American cotton for the formation of a war reserve of rubber.² Official conversations have been held to discuss the measures necessary to ensure an orderly marketing of foreign holdings of American securities, which in case of war would probably be mobilised and realised by the Governments of the different countries concerned.

While the direct effects of the present international tension on the American economy have been small, the indirect effects in undermining business confidence have been more important. As the following figures show, industrial production, which had recovered rapidly during the second half of 1938, showed a declining tendency during the first months of 1939.³

United States: Industrial Production.

1938		1929 = 100.						1939	
VI	XII	I	II	III	IV	V	VI	VII	VIII
65	87	85	82	82	77	77	81		

As has already been seen,⁴ activity has remained particularly depressed in the production of capital goods. This phenomenon has been explained as due to a lack of openings for capital development in an economy as developed as that of the United States, or as the result of an abnormally high cost of construction of capital equipment, or as the consequence of uneasy relations between business and the Administration; but, in part, it is ascribed to the lack of confidence caused by the uncertain outlook for international political relations.

In July 1939, a Bill was presented to the United States Congress embodying proposals of President Roosevelt for a programme of remunerative capital expenditure by the State of some \$2,660 million to be spread over a period up to seven years. This programme included expenditure of \$1,100 million on public works and the construction of bridges and highways, \$460 million on railway equipment to be leased by the

¹ Cf. Chapter II, page 59.
² Cf. Chapter VIII, page 189.
³ The figures of production in April and May 1939 were especially depressed as the result of an important coal strike.
⁴ Cf. Chapter IV, pages 110 and 111.

Government to the railway companies, \$500 million to assist tenant farmers to buy land and an increase of \$100 million in the maximum of loans authorised to be granted by the Export-Import Bank for the promotion of foreign trade. The President had also proposed an increase of \$800 million in the lending powers of the United States Housing Authority, to be used for slum clearance and for projects for the benefit of persons with limited incomes.

In the most recent months, there have been signs of some renewed recovery in the United States. As the figures on page 227 show, industrial production rose somewhat between May and June. Steel output recovered quickly, rising from 45% of capacity in the third week of May to 61% of capacity in the last week of July 1939.¹ Moreover, security prices, after a period of depression and inactivity, rose by 9% between the beginning of July and the beginning of August 1939,² although at the same time commodity prices showed little or no recovery.

The realisation of a substantial improvement in business activity is, however, dependent upon increased confidence. For this reason, even the American economy is at present largely affected by developments in international political relations; and this is even more true of the many other countries whose economic activity is now maintained at a high level by production for war or for war preparations. Continued political tension or the outbreak of hostilities might maintain such activity at the cost of lowered standards of living. The general reduction of expenditure on armaments would release projects of private capital development which are at present abandoned or postponed; but if such projects proved insufficient in volume or in speed of development, it might reduce the level of economic activity in the absence of special measures to promote peacetime developments.

¹ Index of the American Iron and Steel Institute.
² Dow-Jones index of thirty industrial securities.

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