The Great Depression in Europe, 1929-39

Unemployed men in Scotland, 1930The modern world has never experienced an economic crisis as severe as the 'Great Depression'. The term was first coined in the United States to describe the economic collapse that, by 1931, had shattered the US economy and Americans' faith in the future. Europe and the rest of the world were also badly hit, and while they first called the crisis 'a slump', in time the label 'Great Depression' was adopted on both sides of the Atlantic to describe this unprecedented global economic crisis.

Although there were national variations, no part of Europe was left untouched by the Great Depression. In the worst affected countries – Poland, Germany and Austria – one in five of the population was unemployed, and industrial output fell by over 40 per cent. Levels of trade between countries also collapsed. By 1932 the value of European trade had fallen to one-third of its value in 1929, while many of Europe's most respected banking houses and currencies teetered on the brink of collapse. By the end of the decade some semblance of recovery had been achieved, but it was neither complete nor sustained. If preparations for another war had not generated demand and investment, it is very likely the world would have entered a new 'Great Depression' after 1937.

The depression brought mass unemployment and poverty to all levels of European society. As a consequence, domestic politics became increasingly turbulent. In much of central and eastern Europe, as in the Weimar Republic, when politicians from moderate, centrist parties (Liberals, Conservatives, Democratic Socialists) failed to introduce policies to tackle the crisis, they lost out to extremist parties to the Right and Left of the political spectrum. In 1931,

Britain sought to combat this trend by forming a National Government, made up of members from the Conservative, Liberal and Labour parties, to ‘generate national unity’. There were similar developments in France, Belgium and the Netherlands in the mid-1930s.

Relations between countries were also disrupted by the Great Depression. The severity of the crisis pushed countries to protect their national interest above all else. By November 1932, every country in Europe had adopted, or enhanced, tariffs and quota systems to prevent foreign imports from damaging domestic industry and agriculture. The world was now divided into competing trade blocs and this development had profound implications for international peace. For Germany and Italy economic nationalism was the first step on the road to build new Empires. By 1935 it had become clear that their nationalism was not confined to economics, as Mussolini and Hitler began to assert territorial claims in the Mediterranean, Africa and eastern Europe

By then, it was also apparent that the Depression had undermined the ability of other countries to resist these demands. Thanks to their economic troubles, Britain and France felt weak. Diplomatic co-operation, too, proved very difficult in the atmosphere of intense economic competition, even between countries like Britain, France and the United States which shared a common interest in defending democracy and capitalism.

America as the ‘World’s Banker

The origins of the depression begin with the economic and political changes wrought by the First World War. A number of developments were especially significant. The first was the emergence of the United States as the world’s premier economic power: the ‘world’s banker’. America had become the world’s most powerful economy thanks to the way that the Entente powers had come to depend on American loans to fund their war effort, and the way that American business was able to grow rich because of increased demand around the world for its products. As the British economist John Maynard Keynes famously put it, when America sneezed, the rest of the world caught a cold

The First World War and the Allied demands for reparations from the defeated Central powers at the Paris Peace Conference increased the connections between the economies of Europe and the United States. In the 1920s the Americans became the main source of loans for countries that were experiencing currency crises or economic problems in general. In 1924 the Americans stepped in to help the Weimar Republic to stabilise its economy with the Dawes Plan, and over the next five years private American investors lent some $4 billion to Germany. During this time German banks, industries and regional government authorities became used to US dollars smoothing out any shortcomings in their economic performance. Indeed, Germany was not the only nation to benefit from American loans. Europe as a whole received some $7.8 billion between 1924 and 1930. But when these American loans dried up, as they did dramatically after 1929, then problems in European economy resurfaced with a vengeance. What were these problems?

The Challenge of Economic Change

After 1918, the first challenge Europe faced was to reconstruct factories, farmland and homes damaged by the war. More generally, the European powers needed to keep up with the pace of technological change, moving from steam power to electricity for example. In European industry, problems centred on the need to modernise what factories produced and how they produced it. The average worker in American factories now produced twice as much per hour worked as his or her counterpart in Europe, thanks to new technology and methods of working. This made American products cheaper than those made in Europe. European agriculture and primary production also needed to modernise.

Political Change at Home

The war also helped to generate political change that affected how economic policy was made and what it was expected to achieve. The scale and duration of the First World War forced governments across Europe to demand new sacrifices of all its citizens. In return, politicians made promises to extend the vote, to provide improved social

provision and work opportunities.

But for most governments in interwar Europe, it proved much easier to give the vote than to provide funds for unemployment benefits or veterans' pensions, or to formulate economic policies that generated new jobs. At the same time, politics demonstrated how society's expectations of government had changed. Now, when European governments failed to manage the economy to the benefit of the majority of voters, they were more likely to be booted out of office. The fact that Europe was much more democratic than ever before after the First World War only made it easier to be rid of governments which did not deliver on electoral promises when it came to economic policy.

This need to manage the home economy to the satisfaction of the electorate also complicated political relations between states. Now that European governments were more responsive to demands from farmers or industrialists to protect the home market with tariffs or quotas restrictions, there was a much greater potential for 'tit-for-tat' trade wars that damaged both diplomatic relations and levels of international trade. Barriers to trade were on the increase throughout the 1920s, and the problem became much more acute after 1929.

Nor were there any powerful international organisations, like the International Monetary Fund or the European Economic Community that were set up after the Second World War, to counteract economic nationalism, to give assistance to individual countries that suddenly faced a serious domestic economic crisis, or to encourage countries to co-operate together when the health of the world economy as a whole began to deteriorate. This shortcoming was to become very important after 1929.

Inflation and hyperinflation

The first big test for governments came in the early 1920s when levels of inflation began to rise dramatically across Europe. The problem was most acute in Germany, Hungary and Austria, where hyperinflation took hold as governments resorted to printing money in order to pay for the war, economic reconstruction, new welfare demands and reparations. In much of central and eastern Europe, inflation was running at the giddy rate of 2,000 per cent a year. In Britain inflation ran at about 50 per cent, shockingly high by today's standards, but at the time it was the lowest in Europe.

The experience of inflation had a profound impact across Europe. Not only was much of European society deeply scarred by the experience of seeing pensions and savings turn into worthless paper, governments, too, now made currency stability their primary goal.

'Crucified on a cross of gold'

The efforts of European governments to achieve currency stability centred on reconstructing the international gold standard system. This was a fixed exchange mechanism that fixed the exchange value of currencies in relation to the value of gold. It was widely seen as the policy tool to fix all the world's economic problems because it was widely believed the gold standard had generated the tremendous expansion in the world economy in the second half of the nineteenth century. The big benefits of the gold standard were perceived to be two-fold: firstly, the gold standard kept prices steady (therefore there was no further risk of inflation) and, secondly, it facilitated international trade because it eliminated changes in the value of money and eased the process of exchanging one country's money for another's (the gold standard effectively operating like a giant bureau de change).

Between 1924 and 1929 over 40 countries returned to gold or joined the system for the first time. Britain went back on the gold standard in 1925, France in 1926 and Italy in 1927. But there were a host of technical shortcomings in the way the gold standard had been reconstructed after the First World War that had a damaging impact on the world economy. Even more important for the future ability of any government to fight a downturn in the world economy, like that experienced in 1929, were the rules that governed the way member countries made economic policy. These called for confidence in the fixed exchange rate to be maintained by: balanced domestic budgets (governments could only spend as much on public and social services, like unemployment benefit, as they made in

revenue, e.g. taxation), a positive balance of trade (countries exporting more than they imported) and fixing interest rates so as to sustain membership of the system (interest rates had to go up if a gold currency was being sold heavily on the international exchange).

Europe (unlike the booming American economy) struggled to live by these rules, even before 1929. The policy regime that accompanied the gold standard helps to make sense of many of the wrong decisions taken by governments in their first efforts to deal with the economic downturn that hit in 1929.The impact of the gold standard is now seen by historians and economists as the single most important economic cause of the Great Depression.

The Wall Street Crash

The collapse of the American stock market on Wall Street on 24 October 1929 continues to mark the onset of the economic collapse. But historians have long agreed that for central and eastern Europe, at least, an economic recession began in 1928 with demand for both agricultural and industrial goods beginning to decline. The construction of new public buildings and new homes also began to decline that year – always an important indicator for future economic prospects. By the middle of 1929 similar trends were evident in the United States and it was this downturn which helped to trigger a wave of selling on the American stock market. Yet it was not the Wall Street Crash, but the policy response to it, which turned the economic downturn that appeared in the world economy in 1929 into the greatest economic depression ever known.

American bankers believed that speculation in the stock market had been encouraged by easy access to cheap credit, so their response in 1929 and 1930, determined by the logic of the gold standard, was to increase interest rates. This had a dramatic effect on countries around the world. The flow of American loans into Germany and the rest of central and eastern Europe, in particular, soon dried up and the consequences were dramatic. Thanks to this loss of US credit, gold standard membership determined that countries had to raise interest rates, thus making it more difficult for businesses and farms to borrow money at precisely the time they needed to do so to combat depression. Governments, too, began to feel the squeeze as their levels of revenue from taxes fell dramatically just when they needed to spend more money on unemployment benefit and public work schemes to mop up unemployment and to kick-start recovery. Across Europe parliaments, as in Britain and Germany in the summer of 1931, became deadlocked over the issue of government spending. Thanks to the rules of gold standard membership the golden vice squeezed ever tighter around the European economy.

In the Depths of Depression

Confidence in the future now evaporated, which meant that not only were governments cutting back on spending, companies and individuals were too. Demand for industrial and agricultural products dried up, and this caused prices to fall still further. By the end of 1930 the price of wheat sold on the Liverpool exchange had fallen by 50 per cent and the price of meat by 40 per cent. Desperate to protect their own markets from the threat of cheap foreign imports being dumped on them, levels of trade protection began to rise dramatically. By 1932 France had introduced strict quotas on over 3,000 different products entering France, and German tariffs rose by 50 per cent after 1929. Most startling was Britain's retreat into protection in the autumn of 1931, ending a commitment to the ethos of Free Trade that had lasted 85 years. The world was now divided into competing economic blocs.

Countries which depended heavily on the export of agricultural produce were especially hard hit because agricultural prices fell more dramatically than those of industrial goods. A Polish farmer who paid 100 kg of rye to buy a new plough in 1928, now found that the same plough cost 270 kg.

By the summer of 1931, the European economy began to crack under the strain of the continued fall in prices, the lack of demand and spiralling levels of unemployment. Economic, political and financial pressures combined to produce a financial crisis that swept across Europe like a flash flood. In countries, like Austria and Germany, where the banks had a particularly close relationship with industry, the collapse of private companies forced banks, too, to shut up shop. With some of Europe's most prestigious banking houses facing ruin, the German and Austrian

governments were forced to become directly involved in managing the financial system. They also introduced exchange controls to stop the further export of gold or foreign currency from German or Austrian banks to banks in Switzerland or Britain. This action directly violated the rules of the gold standard system, despite German claims that it did not.

The Beginnings of Recovery

A very different banking crisis shook Britain in 1931. Here it was not commercial banks, but the central bank, the Bank of England, that came under pressure. The financial crisis culminated in Britain's abandonment of the gold standard in September 1931. This was a key turning-point in the Great Depression. Sterling now became a floating currency (its value was no longer fixed) and its value fell by some 30 per cent, which immediately made British exports much cheaper. Government was now also freed from the rigorous demands of the rules of the gold standard: these, though sensible enough during periods of sustained economic growth, had made it almost impossible to fight the depression. Interest rates were now cut, making it easier for business and the government to borrow money; and as confidence in the future began to rise, so, too, did society's willingness to buy goods.

Britain was one of the first countries to recover from the Great Depression. After September 1931 the British government's main priority was to foster domestic economic recovery. Britain's recovery strategy also developed a strong regional dimension thanks to special trade concessions given to the Empire and other members of the new Sterling Bloc, comprising 18 other countries – in the Commonwealth, the Empire and Scandinavia – who chose to leave gold in 1931 because they had close links with the British economy.

In April 1933 the new Democrat Administration of Franklin D. Roosevelt in the United States also opted to abandon the gold standard. This meant the new administration was freed from the rules of the gold standard and could draw up new spending plans to give a 'New Deal' to the American people. Because the American economy was, and is, so large, its recovery brought immediate benefits to the rest of the world. For example, now that the American market began to recover, so, too, did American demand for coffee and other primary products from Central and South America.

In Germany the road to economic recovery took a rather different form. Under the Nazi government which took office in January 1933, government intervention in the national economy, like the exchange controls introduced in 1931, evolved into a complex system of trade and monetary restrictions that were used by the Nazis to manage both the domestic economy and Germany's relations with the wider world. Under the Nazis, the state not only controlled trade and the movement of foreign exchange, but also prices, wages, private investment banks and all other aspects of investment. Freed from the rules of the gold standard, the Nazi government also introduced a programme of government spending designed to generate demand and expand income. Between 1933 and 1934 the level of public investment doubled as government funds went straight into employment schemes, industrial investment and construction plans. During 1935 government spending increased by a further 60 per cent, and from there on, public investment in rearmament replaced civilian job creation as the basis for continued expansion.

Germany's drive for national self-sufficiency (autarky) was in marked contrast to the continued commitment of Belgium, the Netherlands and France to the internationalism of the gold standard. They all clung to gold until 1935-36 and this helps to explain why they experienced the worst economic and political crises in the mid-1930s: the worst possible timing when it came to facing German expansionism and Civil War in Spain.

Conclusion

Overall the world struggled to recover from the depression. Levels of international investment remained very low throughout the 1930s, making life especially difficult for the world's poorer countries. The volume of international trade also remained depressed thanks to prohibitively high levels of trade protection. Nor could European governments quite shake free of the fear of financial chaos and inflation. In most countries around the world, government spending remained comparatively low when compared with the period during and after the Second

World War, and large budget deficits were assiduously avoided. Indeed, European governments could not shake the habit of interpreting almost all problems as financial ones. The nature and extent of countries' commitment to the gold standard underlines the importance of policy choices in the history of the interwar economy and of the power of domestic political priorities in shaping economic policy.

In the Great Depression, countries around the world faced very similar problems but they opted to solve them on their own. Although there was talk of the need for international co-operation, notably between the 65 different countries whose representatives attended a World Economic Conference held in London in the summer of 1933, international co-operation amounted to just that: talk. Across Europe, governments of different political complexions, all opted to seek economic renewal in a national or imperial context. By the mid-1930s, moreover, Britain's and France's retreat into empire was being used by Germany, Italy and Japan to justify their demands for empire. Indeed, it was large-scale rearmament, both in Europe, the Far East and after 1939 in the United States that finally soaked up excess industrial capacity that had lain idle since 1929.

Timeline

- 1922-23 Hyperinflation in Germany, Poland, Hungary, Austria; new currencies listed.
- 1924 Dawes Plan. Britain returns to the gold standard.
- 1927 World Economic Conference Geneva. First signs of recession in Germany.
- Oct 1929 Wall Street Crash.
- May 1931 Creditanstalt Crisis, Austria; controls on economy introduced.
- July 1931 Banking Crisi, Germany; controls on economy introduced.
- Sept 1931 Britain leaves the gold standard.
- June 1932 Lausanne conference signals end of reparations. Britain adopts General and Imperial Tariffs.
- April 1933 USA leaves the gold standard.
- June 1933 World Economic Conference, London.

Further Reading

- P Clavin *The Great Depression in Europe 1929-39* (2000)
- C.H. Feinstein, P. Temin and Gianni Toniolo *The European Economy Between the Wars* (1997)
- D. Rothermund *The Global Impact of The Great Depression, 1929-39* (1996)
- W.R. Garside (ed) *Capitalism in Crisis: International Responses to The Great Depression* (1993)

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