

Chapter IIA Overview of 1914-1939: Things fall apart

In most contexts, it would be an absurd and nostalgic exaggeration to consider the years before 1914 a Golden Age of material prosperity, domestic tranquility, and international harmony. But its own context makes those decades most assuredly such a Golden Age, for they came right before a thirty-year period in which almost everything that could go wrong in the world, did. E.H. Carr's influential 1939 book called the era *The Twenty Years' Crisis*, which was wrong only by understatement; the crisis would last thirty years.¹ So too were those who spoke of a European civil war excessively optimistic, as it became a global civil war before it abated.

In the years after 1914, two wars of unprecedented ferocity bracketed the disintegration of almost every aspect of the world economy. Generalized prosperity collapsed into the steepest economic decline in modern history. Extensive global economic cooperation – or at least the absence of major strife over economic issues – erupted into massive international economic battles, from trade wars and competitive currency conflicts to financial hostilities. The generally free movement of goods, capital, and people around the world gave way to the aggressive, often predatory, closure of borders and markets. And within countries, a prevailing socio-political calm shattered into bitter conflict.

Not all of what had come before 1914 was good. The reigning domestic and international stability often preserved an undemocratic and highly unequal status quo. Much of the conflict of the interwar years was due to the new-found access to politics of previously disenfranchised and repressed working classes. What was good about the world before 1914 was only good for some.

But almost everything that came after 1914 was bad, or ended badly, for almost everyone. Social conflicts became civil wars, and civil wars gave rise to brutal dictatorships; commercial conflicts became trade wars, and trade wars gave rise to shooting wars. If the decades before 1914 should not be idealized, the dreadfulness of the decades after it is hard to exaggerate.

The overriding feature of the age was *polarization*, at home and abroad. Countries that had been friends and allies became the bitterest of enemies. Parties and classes that had cooperated and formed coalitions embarked on murderous crusades against each other. And nationalities and ethnic groups who had developed ever more closely as the world economy tied them together came up with unimaginably imaginative ways to rid themselves of one another.

Polarization at home fed into antagonism toward other nations, and international conflicts exacerbated domestic extremisms. The late nineteenth and early twentieth centuries had experienced something of a virtuous circle, in which prosperity at home strengthened peace abroad, which reinforced domestic accord. Over the decades after 1914 the world staggered around a vicious circle, as national economic hardship drove domestic groups to murderous extremes, which in turn bred foreign-policy belligerence and war, which further deepened economic distress. The world spiralled downward, first slowly and then with terrible speed, as all attempts to halt the descent failed.

The principal international economic effect of World War One and its immediate aftermath was to draw the belligerents out of the world economy and toward the war effort; and to pull the United States into the international economic vacuum left by the war. While the American economy had long been the world's largest, before the War it was barely engaged with the rest of the world. With World War One, all of Europe came to depend on American capital, markets, and technology, and to look to it for political leadership. In a few years, the United States went from being a passive observer of the slow collapse of the classical order, to the leader of attempts to reconstitute it. "The change since 1914 in the international position of the United States" was, as the *New York Times'* financial editor wrote after the war, "perhaps the most dramatic transformation of economic history."²

The first step in this remarkably rapid evolution was the introversion of the European belligerents. All had expected a short sharp conflict, and as it became clear that hostilities would drag on, economies had to be reoriented toward the necessities of war. The Central Powers were soon forced to rely on their own resources, for in early 1915 the British Navy mounted a successful blockade. Although this made conditions in Germany and Austria-Hungary more difficult than they would have been with access to overseas suppliers, adequate provisions for the war effort and the citizenry were never threatened, both because of the large size of the continental economies and because of continued imports from adjacent neutrals. But the Central Powers ceased to play any appreciable role in the world economy.

The Allies, on the other hand, remained major global economic actors. However, their position was essentially reversed from conditions of pre-war normalcy. Before 1914, the United Kingdom, France, and Belgium were the center of the classical order: they sent capital and manufactured products to the rest of the world, and imported raw materials in return. Now they had no capital or manufactured goods to spare, and in fact needed to import both; and their demand for raw materials soared with the need for food and raw inputs to make war matériel.

The most immediate impact of the Allies' war needs was on the United States, for it was the United States that was best positioned to meet the demand

for food and armaments. In less than three years of official American neutrality, from August 1914 to April 1917, American exports more than doubled. The country's trade surplus ran at five times pre-war levels to total an accumulated surplus of over \$6.4 billion; this was almost entirely due to new trade with the Allies. American munitions sales abroad, a minuscule \$40 million in 1914, were \$1.3 billion in 1916. Agriculture boomed as Britain lost access to its traditional European food suppliers and turned instead to North America.

The Allies paid for their overseas purchases by selling what they could: goods, gold, and eventually their foreign investments. This was especially the case for Britain, whose investors had large holdings of American stocks and bonds. As the British need for dollars grew desperate, the wartime government repurchased two billion dollars of its citizens' American securities – at first on the market, then by legal requirement – sold them to American investors, and used the proceeds to buy supplies. The British used as their purchasing agent and coordinator the firm of J. P. Morgan and Company, which had decades of experience selling American stocks and bonds to Europeans who wanted to invest their money in the United States. From 1914 to 1917, Morgan's purchases on behalf of its Allied clients averaged a billion dollars a year, and accounted for one-quarter of all American exports. Morgan purchases exceeded the U. S. federal government's total annual pre-war spending.

As suited its prior vocation as economic capital to the world, the United Kingdom served as the financial and commercial coordinator of the Western alliance. The British government lent billions of dollars to its French, Belgian, and Russian allies; coordinated Allied purchases overseas, especially in the United States; and managed the complex job of shipping food and equipment to the allies. From the standpoint of the Allies, Britain was the economic nerve center.

But the British ran out of things to sell long before the war needs of the Allies were satisfied. At the start of the war, the American government decided that loans to the belligerents were inconsistent with neutrality. But by the summer of 1915, the Allies' growing needs came together with the obvious positive impact of wartime sales on the American economy to lead the administration of Woodrow Wilson to change policy. As Treasury Secretary William McAdoo told Wilson, his father-in-law, about the Allied trade, "to maintain our prosperity we must finance it. Otherwise it may stop and that would be disastrous."³

Morgan's was happy to turn the tables and lead the American investing public to British and European loans. For a year and a half starting in October 1915, Morgan's and associated banks brought to Wall Street some 2.6 billion dollars in bonds for Allies, especially the British. This was an enormous sum for so short a period, double the entire outstanding debt of the American government at the time.

Even as the United States jumped to the leadership of international lending, European preoccupation with the War left the rest of the world thirsting for American capital and manufactured goods. As the belligerents deserted the developing world – even their own colonies – in the battle for their homelands, the field was clear for American economic interests. The most striking change was in South America, where European interests had been paramount for centuries. Even in the era of gunboat diplomacy, American influence, Monroe doctrine or no, was limited to the Caribbean basin. In less than a decade, from the start of the war until the end of wartime conditions in 1922 or so, the United States shot to financial, industrial, and commercial leadership in South America.

British international economic leadership was slipping away, but there was no other course but to acquiesce. The chairman of a British interministerial conference to consider alternatives to trans-Atlantic dependency reported glumly in late 1916 that “there was really nothing to deliberate about...American supplies are so necessary to us that reprisals, while they would produce tremendous distress America, would also practically stop the war.” From his position in the Treasury, John Maynard Keynes reported to the British Cabinet, “The sums which this country will require to borrow in the United States of America in the next six to nine months are so enormous, amounting to several times the national debt of that country, that it will be necessary to appeal to every class and section of the investing public....It is hardly an exaggeration to say that in a few months’ time the American executive and the American public will be in a position to dictate to this country on matters that affect us more dearly than them.”⁴

Indeed, the British had reason to worry about quite the opposite, that American investors would lose interest in lending to the Allies as the war dragged on – as indeed Morgan’s told its client governments was about to happen in early 1917. However, American entry into the war in April made further private money unnecessary, as the U.S. government extended nearly ten billion dollars in government-to-government loans to finance the joint war effort. These loans would eventually be at the center of two hot controversies: first, the charge that they were meant to rescue the bad debts Morgan’s had extended and were thus emblematic of the willingness and ability of the Merchants of Death to lead the nation to war for reasons of profit; second, the tangled web of charges and counter-charges between Europeans and Americans over the just distribution of moral responsibility for the Great War, and American insistence that the debts be paid in full, in money when many Europeans felt they had been paid in full, in blood.

The war was devastating to Europe, but this devastation was mirrored by the emergence of the United States as the world’s principal industrial, financial, and trading power. The United States came out of the war immensely more powerful than it went in. American manufacturing production nearly tripled during the war years, from \$23 billion in 1914 to \$60 billion in 1919. In 1913, the

European industrial nations combined – Germany, Britain, France, Belgium – produced substantially more than the United States; by the late 1920s, the United States outproduced these countries by nearly half. Even in trade, the United States shot ahead: in 1913, North America’s total exports were less than one-third those of Western Europe, while by the late 1920s they were more than half as large.

In the space of five years, from 1914 to 1919, America went from being the world’s biggest debtor to being its biggest lender. The European powers were dependent on the United States for financial, commercial, and diplomatic leadership as they dug out from the rubble of the most destructive war the world had ever known. While most of Europe recovered only haltingly, the United States went from strength to strength: the German and British economies did not get back to their pre-war size until 1925, by which point the American economy was half again bigger than it had been in 1914. Countries outside of Europe, whose trade and investment needs had long been satisfied by the Old World, now looked to the United States instead; this was certainly true of Latin America, and even of many of Europe’s own colonies.

It was therefore only natural that planning for the peace, including its economic aspects, would be dominated by the United States. Certainly many in the United States, and especially those businessmen who had come to dominate world trade and finance overnight, welcomed the opportunity. As J.P. Morgan’s most influential partner, Thomas Lamont, put it in 1915, “When that terrible blood-red fog of war burns away we shall see finance still standing firm. We shall see the spectacle of the business men of all nations paying to one another their just debts....We shall see finance standing ready to develop new enterprises; to find money to till new fields; to help rebuild a broken and wreck-strewn world; to set the fires of industry blazing brightly again and lighting up the earth with the triumphs of peace.”⁵

The Paris Peace Conference’s agenda was largely set by U. S. president Woodrow Wilson. Even while the war was raging, the Wilson administration had listed its famous Fourteen Points, which staked out a position that would come to be known as “internationalist” in the American context, for its emphasis on the desirability of international diplomatic and economic cooperation. Economically, the third of Wilson’s points called for “The removal, so far as possible, of all economic barriers and the establishment of an equality of trade conditions.” This was not surprising from the leader of the free-trading Democratic Party, who had spearheaded a dramatic reduction in American tariffs as soon as he took office in 1913. It was associated with more general – and quite new-found – American sympathy for the reversal of policies that impeded the free flow of goods and capital. This, too, was unsurprising given how the United States now dominated international trade and finance, and also given the prominent position in the American delegation of such traditionally

internationalist representatives of Wall Street as Morgan's Thomas Lamont, Norman Davis, Bernard Baruch, and a young John Foster Dulles.

The Wilsonian position was not radically different from the classically liberal British view, although its non-economic components included a greater than traditional insistence on self-determination for national groups (so long as they were not "colored"). This appeared to fortend a considerable shift in America's role in the world political economy, from a peripheral, protectionist, borrower with strong anti-gold leanings, to a bulwark of attempts to restore the pre-war economic order. Cynics might say that as the United States took over Britain's economic position, it discovered that previously suspect British ideological and policy proclivities were suddenly more appealing. Free trade, creditor cooperation, the gold standard all looked much better from the commanding heights of the international economy than they had from its nether, or even middling, regions. As Wilson himself put it, "We have got to finance the world in some important degree, and those who finance the world must understand it and rule it with their spirits and with their minds."⁶

The United States had an overwhelming influence on the Paris Peace Conference. The basic contours of the settlement followed Wilson's Fourteen Points, and his blueprint for a new League of Nations. This is not to say that American positions prevailed everywhere. Prominent among the areas in which the United States acquiesced to the demands of its allied associates was the payment of reparations by Germany. The French and Belgians, especially, insisted on a substantial indemnity to compensate them for the enormous toll the fighting had taken on their territories. Most of the Americans felt these demands were exorbitant and perhaps uncollectible, and would only inflame further conflict. Many in Europe agreed, including a disgusted John Maynard Keynes who quit the British delegation as a result, repaired to England, and wrote a blistering attack on the peace settlement called *The Economic Consequences of the Peace*. But the French and Belgians insisted – and it was not easy to blame them for wanting to exact payment from an undamaged German economy for the loss of untold wealth and life. Despite aspects of the eventual peace that Wilson found distasteful, however, the overall shape of the post-war world seemed unmistakably American in design.

But, in a stunning repudiation of Wilson's views, the U.S. Senate refused to ratify the peace treaty negotiated at Versailles, and refused to approve American membership in the League of Nations that was meant to enforce the new world order. The United States, it turned out, had not evolved as rapidly as its international economic standing. Many in the country felt – and perhaps had good reason to feel – that it was not in American's best interests to be so intricately tied to European countries that seemed constitutionally incapable of governing themselves, or their relations with others, without descending into murderous violence.

“In 1918,” E.H. Carr wrote, “world leadership was offered, by almost universal consent, to the United States...[and] was declined.”⁷ Left to their own devices, the European powers did what they could to rebuild both their own economies and the infrastructure of international trade, finance, and money. In this effort, they were hampered by the enormity of the problems they faced, and by the deep disagreements that continued to divide them. It was no small obstacle that the era’s major commercial and financial power was unwilling to participate in searching for potential solutions to the serious problems that bedevilled the world economy in the 1920s.

Many of the difficulties of the 1920s were unprecedented: the disintegration of centuries-old multinational states, levels of inflation measured in the millions of percent, Communist revolutions. The conflict and its settlement in fact threw much of the European political economy into chaos, which only settled uneasily with a division of the continent into hostile camps among and within nations.

The disarray was most severe in Central and Eastern Europe. The war and its aftermath swept away the four great empires that had made up the region. The lands of Austria-Hungary’s Habsburg and Russia’s Romanov dynasties were divided into pieces, and Eastern Europe suddenly had a dozen new “successor states,” and even a Free City, covering the territory from Finland to Yugoslavia. The Ottoman Empire, which just a couple of years before the War had stretched from the Persian Gulf to Libya, and from Albania to Yemen, was left with Istanbul, its Anatolian hinterland, and an adjacent sliver of Europe. Germany lost its colonies and substantial portions of its territory and population.

The successor states started from scratch, the spawn of defeated autocracies. The scramble to turn former provinces into modern nation states was undertaken in the midst of famine and economic collapse, and the new governments typically had no way to pay their bills other than to print money. The result was a wave of inflation and what came to be called hyper-inflation that destroyed the value of currencies, disrupted economies, and in extreme cases threatened the social fabric of nations.

The post-war inflations were not the simple, gradual price increases of previous episodes. By the time they were able to stabilize prices, the monies of Czechoslovakia, Finland, Yugoslavia, and Greece were left with only 5 to 15 percent of their former values; those of Bulgaria, Romania, Estonia between 1 and 4 percent. But these were not the most extreme cases: hyperinflation in Austria and Hungary did not end before prices had risen 14,000 fold and 23,000 fold respectively – not 14,000 and 23,000 percent, but to levels 14,000 and 23,000 times as high as at the outset. In Poland and Russia prices rose to 2.5 million and *four billion* times their beginning levels. And, in the most famous and grotesque case of all, when the German hyperinflation finally ended in late 1923,

prices were *one million million* times, a trillion times, their immediate post-war level.⁸

As currencies collapsed, the life savings and purchasing power of millions of common Central and Eastern Europeans were wiped out. In September 1922, Ernest Hemingway got what he called “a new aspect on exchange” when he and his wife took a day trip across the Rhine from the French city of Strasbourg to the German town of Kehl. The German hyperinflation was picking up steam, with the mark dropping even faster than German prices could rise. The financial disorder and collapse of the German currency left prices on the German side one-fifth to one-tenth of those in France. With the mark at about 800 to the dollar, Hemingway bought 670 marks: “That 90 cents lasted Mrs. Hemingway and me for a day of heavy spending and at the end of the day we had 120 marks left!”

Our first purchase was from a fruit stand beside the main street of Kehl where an old woman was selling apples, peaches and plums. We picked out five very good-looking apples and gave the old woman a 50 mark note. She gave us back 38 marks in change. A very nice-looking, white-bearded old gentleman saw us buy the apples and raised his hat.

“Pardon me, sir,” he said, rather timidly, in German, “how much were the apples?”

I counted the change and told him 12 marks.

He smiled and shook his head. “I can’t pay. It is too much.”

He went up the street walking very much as white-bearded old gentlemen of the old regime walk in all countries, but he had looked very longingly at the apples. I wish I had offered him some. Twelve marks, on that day, amounted to a little under 2 cents. The old man, whose life’s savings were probably, as most of the non-profiteer classes are, invested in German pre-war and war bonds, could not afford a 12 mark expenditure. He is a type of the people whose incomes do not increase with the falling purchasing value of the mark and the krone....

Because of the customs regulations, which are very strict on persons returning from Germany, the French cannot come over to Kehl and buy up all the cheap goods they would like. But they can come over and eat. It is a sight every afternoon to see the mob that storms the German pastry shops and tea places. The Germans make very good pastries, wonderful pastries, in fact, that, at the present tumbling mark rate, the French of Strasbourg can buy for a less amount apiece than the smallest French coin, the one sou piece. This miracle of exchange makes a swinish spectacle where the youth of the town of Strasbourg crowd into the German pastry shops to eat themselves sick and gorge on fluffy, cream-filled slices of German cake at 5 marks the slice. The contents of a pastry shop are swept clear in half an hour....

The proprietor and his helper were surly and didn’t seem particularly happy when all the cakes were sold. The mark was falling faster than they could bake....

As the last of the afternoon tea-ers and pastry-eaters went Strasburgwards across the bridge the first of the exchange pirates coming over to

raid Kehl for cheap dinners began to arrive. The two streams passed each other on the bridge and the two disconsolate-looking German soldiers looked on.⁹

The experience may have contributed to Hemingway's distaste for inflation, expressed a decade later. "The first panacea for a mismanaged nation," he wrote, "is inflation of the currency; the second is war. Both bring a temporary prosperity; both bring a permanent ruin. But both are the refuge of political and economic opportunists."¹⁰ Certainly the German middle classes, ruined by the hyperinflation, came away from it with a fanatical resolve to avoid any debasement of the currency.

In most cases, the inflations and hyperinflations were ended with a mix of austere fiscal policies and foreign support. Taxes were raised, spending was cut, and so the government's need to print money was reduced. But to regain the confidence of the public, the monetary authorities usually had to prove that they had the backing of the major financial powers. This they did, typically, under the auspices of the League of Nations, in collaboration with the central banks of the leading Western powers, and with the backing of private London and New York financiers.¹¹ Although difficult and socially costly, stabilization had largely been achieved within a few years of independence.

The case of Germany was special in several ways. One was sheer size: debilitating hyperinflation in Hungary was hardly as serious for the rest of the world as the collapse of the biggest economy in Europe. Another was Germany's position as the principal defeated power (Austria-Hungary and the Ottoman Empire no longer existed, and Bulgaria was hardly a major player). For hyperinflation was closely related to reparations. The relationship was controversial – the Germans argued that attempts to pay caused the collapse, the French insisted that the Germans were printing money with abandon because they refused to make serious efforts to pay. Either way, it was clear that the German hyperinflation was unlikely to end so long as the reparations issue remained unresolved. As the French demanded payments ever more insistently, the German economy collapsed ever further.

Eventually it became clear that the game of brinksmanship was harming all sides, and the logjam began to free. In late 1923 the German government undertook serious measures to get control of the economy. The 1924 Dawes Plan committed \$200 million to stabilize the mark, and regularized reparations payments by appointing an American to supervise the proceedings. Given the U. S. government's withdrawal from active participation in European political and financial matters, the process was handled privately – half the loan was made by J. P. Morgan and Company, and the Agent-General for Reparations was an American Morgan associate.¹² By late 1924 Germany, too, had beaten back hyperinflation and begun to grow.

Although the macroeconomic collapses of the early 1920s passed, they left an enduring legacy. The devastations of inflation further discredited traditional conservative political leaders. They seemed to have no solution to the problem, and in many countries big business seemed oblivious to the suffering hyperinflation and stabilization imposed on erstwhile middle-class allies. While the wealthy could protect themselves as the national currency lost its value – by investing in real assets or taking their money abroad, for example – the middle classes often had no recourse and lost all their savings in the space of months. It was nothing new to labor and the Left that capital and the traditional Right would and could only act in their own narrow self-interest; the disorganization of the early 1920s seemed to demonstrate to the middle classes, too, that pre-war elites were unfit to rule. In this way, the economic failures of the early post-war years helped smooth the path for the New Right of the 1930s – and indeed, already in the middle 1920s fascist-style movements were gaining favor, even power, throughout southern and eastern Europe.

The collapse of pre-war ruling classes was nowhere as obvious as in Russia. Tsarist wartime failure led to a democratic revolution in March 1917, then a seizure of power by extreme anti-war socialists in November. The country sued for peace and accepted harsh terms from Germany to achieve it, only to be torn by a bitter civil war that lasted until late 1920. By then – much to the surprise and chagrin of the West – the Bolsheviks were fully in control of the world's largest country.

Bolshevik leader V.I. Lenin was not alone in thinking that the Russian Revolution would be only the first in a wave of radical revolts against Europe's failed regimes. In the year or so after the war ended, insurrections in Berlin and Bavaria, a Communist seizure of power in Hungary, and massive factory occupations in Italy all seemed part of a broader trend toward workers' revolution. Socialist parties around the world were torn by conflict. The traditionalists' support for the war now tarnished their image; their electoral strategies had brought them influence, and even power, but this was a decidedly mixed blessing as they ended up implicated in ineffectual caretaker governments. Insurrectionary wings of every socialist party ridiculed their attachment to national patriotism, and their belief that the ballot box could change society. Eventually a new International based in Moscow brought together Communist parties from all over the world.

But the early revolutionary optimism soon faded, and Lenin and his colleagues were left in control of a shattered country that even in better days had appeared to be unpromising soil for socialism. The new Soviet Union was faced with a daunting task of reconstruction from war, revolution, and civil war; it was hard to imagine building a new socialist society in a country which by 1920 had lost seven-eighths of its 1913 industrial capacity.¹³ In fact, during the first post-war years, the Soviets concentrated on bringing the economy back to life. The 1921 New Economic Policy permitted substantial private enterprise,

especially in small business and farming, and Soviet leaders encouraged the peasants to enrich themselves as best they could. By 1924, as elsewhere in the East, the economy was growing again. While the Soviet Union remained even more insular than Russia had been before – in part by choice, in part due to the hostility of the capitalist nations that surrounded it – it did gradually rebuild its economic ties with the rest of the world.

Post-war reconstruction was far less difficult for the western allies than in Eastern and Central Europe. Wartime destruction was limited to Belgium and northern France, where it was severe but where eventual reparations did help the process of rebuilding. Elsewhere, and even there, economies recovered quickly. There was a very rapid boom in 1919 and into 1920, followed by a sharp recession in 1920 and 1921, but by 1922 business conditions were clearly returning to normalcy.

Despite their best efforts, however, the Western Europeans were not able simply to pick up where they had left off economically in 1913. The belligerents, and other nations as well, had imposed many barriers to international trade and investment during and after the War, and it proved difficult to remove trade protection once wartime conditions ended. In the United States, the substantial trade liberalization enacted by Wilson and the Democrats in 1913 was reversed and more by the Republican administration and Congress in 1921 and 1922, by which time the United States had gone back to its traditional protectionism. Even the British left in place some of the trade barriers adopted in wartime. And many of the new nations in Central and Eastern Europe were resolutely protectionist, much more so than the empires that had preceded them.

The most systematic attempt to reestablish pre-war conditions was monetary, as a restored gold standard became the goal toward which all Europe strove. Two European monetary conferences, at Brussels in 1920 and Genoa in 1922, gave resounding support to this objective, but even countries that had not undergone massive inflation found its achievement difficult. In Great Britain, prices had risen enough during and after the war that the attempt to go back to the 1913 exchange rate against gold required very restrictive monetary policies to cut wages, profits, and prices. Even then, when sterling returned to gold in 1925, much of British industry found itself priced out of world markets. Largely as a result, British unemployment stayed above ten percent through the 1920s. The Scandinavian countries stabilized with or following after Britain. Their close trade ties to the British market, and British-like overvaluations, also saddled them with double-digit unemployment for the entire decade: Norway's attempt to return to gold helped bring its unemployment rate over 25 percent in 1927. Belgium and France went back onto gold soon after Britain, but with their currencies at only a fraction of their pre-war values and thus at much less cost.

Despite the disappointments, Europe had essentially recovered by 1924. In that year, European industrial production returned to its 1913 levels. To be sure, this masked differences within Europe: industry in the West was

producing 12 percent above 1913 levels, while in central and Eastern Europe it remained over 20 percent below them. And the United States, not surprisingly, was far ahead of this pace, with manufacturing output nearly half again as large as in 1913.¹⁴ Nonetheless, given the human, economic, and political devastation of World War One, it was no trivial matter that economic conditions and living standards were now back to where they had been before the War.

Eager to break free from the imposed self-absorption of war and reconstruction, as soon as they could firms and people embarked on an orgy of outward-looking international economic activity. Between 1925 and 1929 the world's industrial production grew by more than one-fifth, even faster in Europe and North America. Raw materials output rose more rapidly still, although agriculture lagged. International investment reached levels reminiscent of its glory years in the early twentieth century, although now it came mostly from the United States rather than from Europe. Exports swelled, to double pre-World War One levels; even accounting for inflation, world trade was 42 percent greater in 1929 than in 1913, and was a larger share of national economies.¹⁵ The gold standard was back in place, albeit somewhat shakily. The world appeared restored, if clearly transformed.

The effects of the rapid economic expansion were magnified by, and helped encourage, major social changes. In most of the industrial world, the 1920s saw the rise of new mass production and mass consumption goods. Politically, virtually all democratic countries introduced female suffrage amidst broader movements for the emancipation of women; labor movements and socialist parties dramatically increased their influence. Modernist and surrealist cultural movements revolutionized the arts, and jazz burst onto the international musical scene. The boom of the late 1920s was so pronounced, and its effects so broad and deep, that many countries gave it a proper name: the Weimar Renaissance in Germany, the Baldwin Age in Britain, the Roaring Twenties in North America, the Dance of the Millions in Latin America.

To some extent this rapid growth involved catching up after the stress of wartime conditions. But it also had a powerful dynamic of its own, and its economic centerpiece was the United States. American capital and American markets fuelled economic growth from Asia to Latin America, and especially in Europe. American banks and corporations flooded the world with money and technology. Wall Street took over London's prior position as the world's international financial center, even as American corporations set up thousands of branch plants around the world. By 1929, the United States had accumulated over \$15 billion in foreign investments, about half in loans and half in the direct investments of multinational corporations, and this did not even include the many billions of dollars owed by foreigners to the U.S. government. The country had, in a little more than a decade, put together an international investment portfolio almost as large as that of the United Kingdom in 1913, which had been

assembled over the course of over a century. In the words of turn-of-the-century Secretary of State John Hay, “the financial center of the world, which required thousands of years to journey from the Euphrates to the Thames and Seine, seems passing to the Hudson between daybreak and dark.”¹⁶

Loans surged out of New York at the rate of more than a billion dollars a year from 1919 to 1929, as American investors scrambled to buy foreign bonds. In peak years, there were nearly one-third as many foreign bonds floated on Wall Street as bonds of American corporations.¹⁷ From 1924 to 1928 Americans lent an average of a half billion dollars a year to Europe, another \$300 million a year to Latin America, another \$200 million to Canada, another \$100 million to Asia. The world was swimming in dollars, for Americans seemed to have an inexhaustible interest in financing ventures in lands few had heard of a decade before: 36 American investment banks fought over the privilege of floating the bonds of the city of Budapest, 14 competed over Belgrade, and a village in Bavaria looking for \$125,000 found itself convinced to borrow \$3 million.¹⁸

The United States was not alone in this recovery of international finance, although it did account for more than half of the new loans extended. Especially after returning to gold, the London markets reopened, as did lending from Paris, Amsterdam, and other smaller European creditor capitals. Overall, Britain took up about a quarter of the new loans of the 1920s, other European countries another quarter.¹⁹ After ten years of domestic preoccupations and restrictions on international business, neither borrowers nor lenders seemed able to get enough of the revival of world capital markets.

As lending from Wall Street exploded, American non-financial corporations searched the world for other profitable investment opportunities – not loans, but “direct” investments in branch plants and other subsidiaries. American firms invested more than five billion dollars in this way over the 1920s, by the end of which American corporations were well established in every major economy, and many minor ones as well. Even American commercial banks, which before the Federal Reserve Act of 1913 had largely been prohibited to operate overseas, got into the act, and by the late 1920s had nearly two hundred branches abroad.

The boom of the 1920s was if anything more pronounced outside Europe than in it. In Latin America, the flood of American loans and American direct investment was associated with the region’s most rapid growth in memory. Latin America in fact grew more than half again faster than Western Europe and North America in the 1920s.²⁰ In the process, its industrial structure matured substantially; by 1929, for example, Brazil was producing at home three-quarters of the steel it needed.²¹ Around the region, economies were modernized, enlarged working and middle classes became politically prominent, and democratic regimes stabilized.

These years of recovery and boom were reminiscent of the Golden Age before World War One, with the United States replacing the United Kingdom at

its center. In the earlier era, economic activity all over the world had been financed out of London, largely by loans but also by private corporate investment. Debtor countries earned the money they needed to pay interest and principal by exporting to Europe, especially to the large and open British market. And the system was held together by a commitment to a common monetary standard, gold. By 1925, a comparable system was in place, as capital flowed from the United States to the rest of the world, the rest of the world sold heavily into the American market, and almost all major currencies were back on gold.

However, the second incarnation of this order brings to mind Marx's observation that while history may repeat itself, it is "the first time as tragedy, the second as farce." For while the economic cornerstones of the two eras were similar, the world's access to the capital and markets of the United Kingdom and the United States respectively, the behavior of the center countries diverged in fundamental ways. In the years before World War One, British commitment to free trade was nearly complete; even when it was challenged by the movement for Empire preferences, this challenge was beaten back. The British government was deeply and continually involved in discussions with other governments over international monetary, commercial, and investment problems, and its concern to ensure the continuation of the system was unquestioned.

While American capital and markets dominated the world economy in the 1920s as much as their British counterparts did before 1913, the United States government was almost wholly absent where that of Britain had been ever-present. Even if it had wanted to be engaged – which it did not – the American administration was prohibited by Congress from official involvement in international discussions of economic (and most other) issues. Only the Federal Reserve Bank of New York, close to the international bankers on Wall Street, made a concerted effort to participate in global economic affairs, and it had to do so surreptitiously. Indeed, the American representatives to international monetary meetings were usually private bankers from J. P. Morgan and Company. American trade policy was resolutely protectionist, even though it was well understood that this hampered the ability of the country's overseas debtors to earn the dollars they needed to service their loans. And even the country's commitment to gold was suspect, for a new wave of anti-gold populism swept the American farm belt as agricultural prices dropped by one-third over the 1920s.

Foremost among the irritants caused by American disengagement was the continuing squabble over reparations. The attempts of Germany's moderate Weimar governments to maintain their international commitments rankled domestically, although prosperity softened the bitterness. Indeed, many in Europe had come around to the view of Keynes, that the payments schedule was too harsh and counter-productive. But from the standpoint of the French and Belgians, reparations were a necessary evil so long as the United States government continued to insist that its former allies repay their war debts. The

obvious solution – cancel the war debts and reduce reparations – would have ameliorated some of the festering anger that haunted European politics, but it confronted an implacable obstacle. In the words of Calvin Coolidge, “They hired the money,” and Americans were in no mood to forgive the debts.

So long as American money kept flowing to Europe, Asia, and Latin America, so long as the rest of the world could tap American capital and American markets, the world economy kept growing. The institutional and other infrastructure that had helped stabilize the world economy before 1913 was lacking, but the world made do without it – an apparently endless stream of dollars seemed a reasonable substitute. When the American fuel dried up, however, the merry-go-round it had been powering ground to a halt.

The end came quickly and ferociously. It started innocently enough, with a gradual decline in growth outside of North America. World agricultural prices had been depressed through the 1920s, but in 1928 farm conditions in the major producers took a turn for the worse. Meanwhile, much of Europe and Asia seemed to be falling into recession. The United States continued to boom. With foreign investments less attractive, American capital headed home, and the stock market experienced a remarkable surge: the Dow Jones Industrial average, at 191 early in 1928, rose nearly without interruption to 381 by September 1929.

A doubling of stock prices in little over a year far surpassed any return available in foreign lending, and the supply of American money to the world dried up. In the first half of 1928 new American lending to foreigners averaged \$140 million a month; this declined by half to \$70 million between mid-1928 and mid-1929 as money flooded into the stock market; and by the last half of 1929 foreign loans were down by another half, to \$35 million a month. If one takes into account money coming back to the United States as outstanding debts were repaid, an even starker picture emerges: a net outflow of \$900 million in 1927-28 turned into a net outflow of just \$86 million a year between 1929 and 1931.²²

American money had provided the momentum for world economic growth. When it turned homeward, it left the rest of the world gasping, and turned a mild recession into a full-fledged crisis. As money flooded toward the United States and the dollar, investors unloaded other currencies. European governments facing such a sell-off on the foreign exchanges moved quickly to respond as they had so commonly in the decades before 1914: raise interest rates and impose austerity. The hope was that higher interest rates would attract capital back to the economy and its currency, while austerity would restrain wages and profits in order to make the country’s goods more competitive on world markets. All this meant imposing further recession on already troubled economies. The orthodox creed was as it had been: after the world economy rebounds, and order is restored, good behavior will surely be rewarded, and these sacrifices will not have been in vain.

Even in the United States, the central role of American lending in the operation of the world economy confronted the American authorities with serious challenges. The Federal Reserve was concerned about what it regarded as excessive speculative behavior on Wall Street, and wanted to raise interest rates to draw money away from stocks, make it harder to borrow, and so discourage speculators. But an increase in American interest rates would only suck more capital out of Europe and Latin America, making business conditions that much more difficult there. If the Fed kept interest rates where they were, the stock market bubble would continue to distort the U.S. economy; if it raised interest rates to moderate the market, it would exacerbate the economic problems of an already fragile Europe. In the event, the Fed felt that its principal commitment was to its domestic mandate, and in August the Fed raised interest rates a percentage point, and attempted to use its powers of persuasion to discourage further stock market speculation. This certainly made European conditions more difficult, deepening a recession that was now in full swing, and it hardly seemed to moderate the stock market's rise.

Finally, in late October 1929, the frenzy came to an end. In three weeks the market lost all the ground it had gained in the previous year and a half. Yet rather than reduce the strains that had built up, the crash seemed to exacerbate underlying economic weaknesses. In the space of three months, American industrial production fell by 10 percent and imports by 20 percent, while prices began a rapid decline, led by already-weak raw materials and agricultural prices. The stock market crash interacted with overall economic fragility to exacerbate the skittishness of financial markets. The result was to put further pressure on economies overseas.

In the face of ever greater problems, pressures mounted to try alternatives to the orthodox responses. These alternatives all involved one sort of deviation or another from normally acceptable international behavior. One course of action, especially relevant to the heavily indebted countries of Europe and Latin America, was for the government to suspend payments on its foreign debt. This would reduce the outflow of funds and free up money both to defend the currency and to spend on domestic purchases that would help the economy recover. To default, however, was tantamount to abandoning the international financial system, with no guarantee of being able to restore oneself to its good graces and return to borrowing in the near future. Or the government could take the currency off gold and allow it to depreciate. This would avoid raising interest rates and other austerity measures, but it had a number of detrimental effects. It harmed the international credibility of the government: countries off gold were still regarded as second-class citizens of the financial community, although the demotion was less severe than for defaulters. And a devaluation also raised the burden of foreign debts: a 25 percent decline in the peso against the dollar, for example, meant that dollar debts were now 25 percent bigger in

peso terms. In addition, for some European countries, the threat of a devaluation raised the early-1920s spectre of a return to inflation and hyperinflation.

Within a few months of the American stock market collapse, Argentina, Australia, Brazil, and Canada made their choice: they all formally or informally took their currencies off gold. These four major commodity producers had been especially hard hit by the combined effect of price declines, the slump in American and European demand for their exports, and the cutoff of American lending. Their defection from gold-standard rules was worrisome, but they were after all relatively minor economies facing a very serious commodity price slump.

The major countries continued to follow the usual prescriptions. But the results were troubling: in virtually all the developed world, industrial production continued to fall rapidly while unemployment rose to alarming levels. The process was especially pronounced in the United States and Germany. In the United States, from its August 1929 peak to October 1930 the slide was frightening: industrial production dropped 26 percent, prices by 14 percent, personal income 16 percent.²³ The average household had lost the income gains of the previous five years and more – and there was no sign of a letup in the decline. Unemployment, too, was on the rise: from 3 percent in 1929, the jobless rate went to 9 percent in 1930, and kept going up, to 16 percent in 1931. The German collapse was even faster, from 8 percent unemployment in 1928 to 22 percent in 1930 and 34 percent in 1931.²⁴ The already weak British economy turned down further, bringing with it the Scandinavian and Baltic countries in its commercial orbit. Japan was dragged down by the lending cutoff and a 43 percent decline in the price of silk, its principal export, over the course of a year. As economic decline set in, only France seemed immune to what was now clearly a world-wide crisis, and by the end of 1930 the French expansion, too, seemed precarious at best.

Industry ground to a halt and the streets filled with the jobless, while governments redoubled their efforts to devise effective responses. Most of them scrambled to shore up confidence in their commitments to gold and to paying their debts. There even seemed to be progress on the issue of reparations, as a European conference chaired by American businessman Owen Young agreed to regularize German payments. The Young Plan also established a Bank for International Settlements to help smoothe the process and, it was hoped, to provide a venue for more general international monetary and financial cooperation.²⁵ As monetary and financial difficulties multiplied, the leaders of the principal central banks consulted almost continually to try to craft a way out. And in February 1930, an international conference to reduce trade barriers was convened.

These international initiatives were too halting and ineffectual, and most governments relied on their own efforts to try to pull themselves out of the decline. Great Britain seemed uniquely suited to search for imaginative

alternatives. In July 1929, a minority Labour government headed by Ramsay MacDonald took power, ruling with the support of the Liberals and the backing of some of the country's leading economic thinkers, including Keynes. Yet the government was immobilized by the conflicting pull of its constituents. On the one hand, it held firm to the country's traditional commitment to free trade, balanced budgets, and the gold standard; on the other, it was desperate to respond to the insistent demands of collapsing industry and unemployed workers. In the end it temporized ineffectually for two years.

Germany, probably hardest hit by the crisis, was torn apart even more completely. Two years of traditional austerity succeeded only in driving unemployment to astronomical levels. The coalition center-left government collapsed early in 1930, to be replaced by the government by decree of Heinrich Brüning, a prominent Catholic politician. Brüning, too, seemed to have no new ideas, and responded to parliamentary resistance by calling a new election in September 1930. The result stunned him and the other established parties: its principal result was a great increase in political support for the two parties least committed to orthodoxy, the Communists and the Nazis. The former took 13 percent of the vote, up from 10 percent two years earlier; the latter increased their popular votes from under three percent to 18 percent. The country had divided into openly warring factions, with its international economic relations one of the principal battlefields.

The United States government, too, persevered in going it alone, searching for traditional American responses to economic downturns. The first such traditional response was trade protection. From the middle of 1929 through early 1930, Congress worked on the Smoot-Hawley Tariff Act, which promised to raise substantially American trade barriers. Despite pleas from foreign trade partners, and even from a petition of 1,028 American economists, Congress passed the bill and President Herbert Hoover signed it in June 1930. Within a few months, other countries also began raising their own trade barriers, whether for their own reasons or in retaliation.²⁶

American monetary policy, too, turned to the usual tools. The Fed's principal concern was to impose a sharp and quick bout of austerity. This policy of "liquidationism" emphasized the need to keep conditions difficult in order to force prices and wages down to the point where excess stocks – of labor, food, goods – could be liquidated. The advice of Treasury Secretary Andrew Mellon to President Hoover was typical: "Liquidate labor, liquidate stocks, liquidate the farmers, liquidate real estate...purge the rottenness out of the system."²⁷ So the Fed kept interest rates relatively high – 2 ½ percent at a time when prices were falling at about 15 percent a year – and attempted to oversee an orderly working out of what it still believed was a typical cyclical decline like that of, say, 1920-1921. Prices and wages would fall until eventually demand rose to meet supply, then the economy would rebound.

It was not to be. In early 1931, the bottom fell out of the system. In May, the Creditanstalt, Austria's largest bank and a long-time Rothschild affiliate, failed. The government stepped in immediately, and was able to mobilize support from other European capitals, but it was to no avail. The problem would soon become familiar. Depositors would not keep money in banks that were in imminent danger of closing their doors, so a run on the banks developed at the first sign of difficulties. As the nation's banks threatened to collapse, people scrambled to get their money out of the country – nobody was willing to entrust funds to a financial system in the process of disintegration. This eventually forced the government to suspend convertibility into gold, as no amount of austerity and no interest rate increases would attract money back to the currency of a country in the throes of a bank panic. And as rumors spread that the currency would be taken off gold and devalued, this only accelerated the rush to sell off stocks, bonds, and money to cash them in for gold or a reliable currency. All the aspects of the vicious circle fed on each other, and any one failure could trigger the others: expectations of a devaluation could cause a bank panic, and vice versa.

Within a week, the bank runs spread from Austria to neighboring Hungary. Within a month, they reached Germany. In this environment, the smart thing for anyone who could was to get money out of the banks, out of the questionable national currencies, into gold or dollars, as soon as possible – and so the crisis reinforced itself as these interconnected economies pulled each other down. Conscious of the delicate situation, President Hoover attempted to help hold off disaster by proposing on June 20 to allow war debtors to suspend payments on their obligations to the United States government for a year until conditions improved. This was sure to help, but savers all over Central Europe remained gripped by the fear that nothing could keep bank failures from striking the continent's leading economy, and forcing Germany off gold. They were right. Despite attempts to gather support from the French and British, in July 1931 the German government closed its banks and suspended the convertibility of the currency into gold and foreign exchange. The exchange rate was kept officially steady, but it was now virtually impossible to exchange the German currency for gold, dollars, sterling, or anything other than German goods.

The fact that the crisis had forced Germany off gold only excited more fears, and the fearful soon turned to the financial cornerstone of Europe, the United Kingdom. Within days of the German decision, the pound sterling was being sold off massively by worried investors. Over the late summer the British government struggled to support the pound without implementing austerity measures. Finally, in late August, the Labour government collapsed and was replaced by a National Government, also headed by Ramsay MacDonald but now with substantial Conservative support. Almost immediately, the new government took sterling off gold, devaluing it for the first time in peacetime since the gold parity was established by Sir Isaac Newton in 1717.

When the pound fell, it fell hard – by nearly one-third against the dollar in a couple of months, from its historical \$4.86 to \$3.25. As sterling dropped, a whole host of other countries followed Britain off gold – the Scandinavian and Baltic states with close ties to the British market, then Japan, then most of Latin America. At the same time, most of these countries imposed substantial barriers to trade. Most striking was Britain’s final abandonment of nearly a century of free trade; in February 1932 the National government imposed broad tariff protection, then negotiated special preferences for the Empire and a few favored trading partners whose export goods were not in strong competition with British producers. Empire Preferences had been established, and a “sterling bloc” formed around the United Kingdom, sharing depreciated currencies and preferential trade relations. While trade with the rest of the world fell precipitously, exports to the sterling area – the Empire, the Nordic and Baltic countries, Argentina, and a few others – rose from 50 to 60 percent of Britain’s total exports.²⁸ Other imperial powers similarly tightened their economic ties with their colonies, and in 1931 Japan expanded its colonial area by occupying and annexing Manchuria in North China.

By the end of 1932, effectively only two groups of countries were left on gold: the United States, and a French-centered “gold bloc” that included Belgium, Luxembourg, the Netherlands, Italy, and Switzerland. The devaluations elsewhere faced the remaining gold countries with strong competitive pressures in both their own and third markets, as suddenly cheapened British, Japanese, and other goods found ready buyers. And the ever higher tariff barriers imposed by all – whether in the increasingly closed European empires, Japan’s expanding imperial sphere, the United States, or Latin America – reduced trading possibilities still further. The world had entered a spiral of “beggar-thy-neighbor” policies: country after country tried to recover by devaluing, imposing tariff protection, defaulting on its foreign debts. Each competitive devaluation or trade war exacerbated conditions elsewhere, until the aggrieved partners responded in kind, and the spiral continued.

Still the remaining gold countries held on, but the underlying economic situation was becoming untenable. World trade had collapsed; by the end of 1932 it was at barely one-third its 1929 levels. International financial markets were almost completely inactive. All of the world’s leading trading nations had turned unambiguously toward protectionism. In the United States, industrial production stood at half its 1929 levels, and unemployment was 24 percent; it was a staggering 44 percent in Germany.²⁹ Latin America was hit by the double whammy of falling prices and falling demand; between the two, the region had to reduce its imports by more than half over the first three years of the Depression. Almost every country in the region was now in default, with the notable exception of an Argentina desperate to stay in the good graces of its traditional British trading and financial partners.³⁰

The American elections in November 1932 brought Franklin D. Roosevelt to the presidency, and the Democratic sweep of Congress seemed to give him a free hand. To some, this appeared encouraging, as it brought back to office the internationalists who had been pushed aside by American isolationism in 1920; after all, the President-elect himself had been the defeated Wilsonian 1920 vice presidential candidate. But the immediate impact of the Democratic landslide was to provoke the same sort of panic that had beset Europe. The Democrats relied for support on farmers who had always been ambivalent about the gold standard, and who had been clamoring for a devaluation since before the Depression began. By 1933, American farm prices were barely half their already depressed 1928 level, while other prices had gone down by much less – 8 percent for consumer durables, 18 percent for metal products.³¹ As the four months from election to inauguration dragged on, Roosevelt was careful not to pronounce himself on whether he would defend the dollar's gold value, but members of his future cabinet were not so coy. Henry Wallace, a prominent farm leader already announced as the new Secretary of Agriculture, said six weeks before the new administration took office: "The smart thing would be to go off the gold standard a little further than England has."³²

As soon as it came into session, in fact, Congress took up measures to force the dollar off gold. The future seemed clear: one way or another, the dollar would be devalued. A run on America's banks ensued, starting in February and spreading throughout the country until the eve of Roosevelt's inauguration on March 4, 1933. As in Austria, Germany, Britain, and elsewhere, given the expectation that the currency would soon be taken off gold, the smart thing to do was cash in dollars and buy gold. As soon as he took office, Roosevelt closed the nation's banks and announced emergency measures to stabilize the financial system. For a few weeks the dollar held steady as it seemed the Administration might re-commit to gold. But in mid-April, Roosevelt confirmed the accuracy of the speculators' expectations and took the dollar off gold.

After mid-April, the dollar was allowed to decline continually. In three months, it dropped against sterling from \$3.42 back roughly to the \$4.86 price it had held before the pound's devaluation. It floated, generally downward, for another six months until in February 1934 Roosevelt re-fixed the dollar at \$35 an ounce, more than two-thirds below the long-standing \$20.67/ounce gold parity. As if to reinforce his sense of priorities, over the summer of 1933 Roosevelt effectively shut down a World Economic Conference in London that had been trying to work out some form of international monetary cooperation. In a strongly worded message on July 3, Roosevelt insisted that "the sound internal economic situation of a nation is a greater factor in its well-being than the price of its currency." He lashed out at "the old fetishes of so-called international bankers," which were, he said, "being replaced by efforts to plan national currencies with the objective of giving those currencies a continuing purchasing power."³³ It was hard to imagine a more trenchant rejection of the traditional

rules of the classical international economy. The day the dollar was taken off gold, Lewis Douglas said glumly, "This is the end of Western civilization."³⁴

The world economy was dead in the water. Trade, investment, and lending were at small fractions of previous levels. Economic activity in every country was down by unprecedented amounts; all the hard-won gains of the 1920s were erased in the space of months, and as the months wore on they slid ever further. Economic warfare waged across Europe and the Atlantic: war debts were repudiated, trade wars declared, competitive devaluations and exchange controls celebrated, reparations denied. All this fed into an atmosphere of desperation, political polarization, and mutual recrimination.

The year 1933 was the economic nadir of the Depression. A general and gradual recovery began in 1934, and continued until 1937. By then, in most nations unemployment was half or less of its 1933-34 peak, although it remained high almost everywhere. Recovery was interrupted by a further recession in 1937, which hit the United States harder than most of the rest of the world. This downturn was relatively brief, and the resumption of normal activity was speeded by the rapid pace of rearmament in a Europe already preparing for war. Nonetheless, economic conditions were very difficult for the remainder of the decade, and the economic problems were compounded by the increasing political tensions both at home and abroad.

As the industrial countries faced the most serious economic crisis in living memory, they all confronted the tradeoff between international commitments and domestic considerations. This choice, routinely made in favor of foreign ties before World War One, had gotten more and more politically difficult as the 1920s wore on. On the one hand, the parlous state of the world economy undermined arguments that national sacrifices were justified by the access to global markets they would eventually bring; moribund global goods and capital markets hardly seemed worth sacrificing for. On the other hand, the laboring classes were ever more fully represented in national politics, and while they were not inherently opposed to global economic integration it had scarcely escaped their notice that whenever sacrifices were called for on its behalf, they were the ones asked to do the sacrificing. After 1929, the choices were starker than ever: astronomical unemployment and mass farm distress in return for the highly questionable benefits of international rectitude. And, for perhaps the first time in a century, virtually everywhere the overwhelming balance of influence and opinion lay on the side of taking care of domestic conditions first and foremost.

As the slump of 1929-1930 tailed into the collapse of 1931-1933, every government tried to shield its national economy from the failing world trading system. Even the Netherlands, whose commitment to free trade went back centuries further even than that of the United Kingdom, imposed protective tariffs on farm imports. Established protectionist systems were, as in the United States and France, strengthened. The new fascist governments typically

imposed strict controls on trade, investment, and currencies. In the dire conditions of the early 1930s, no government could afford the abstraction of a commitment to international cooperation and comparative advantage. More to the point, the political standing of those in the business community who were the strongest supporters of liberalism – international bankers, foreign investors, exporters – was severely undercut by the obvious failure of the system on which they depended and of which they were integral parts. Whatever the rhetorical or philosophical underpinnings of free trade, free capital movements, and the gold standard, governments chose them – where they did – because the political supporters of these policies were powerful. World economic collapse made it hard to argue for the broad desirability of attachment to the world economy; and it sapped the strength of the economic internationalists.

But by 1936, with recovery in full swing, strong differences emerged between those whose turn inward was temporary and emergency, and those who saw economic insulation as a long-term strategy. The former began halting moves to reduce trade barriers and reconstitute the international monetary system; the latter circled their economic wagons ever more resolutely. And the fact that, with the prominent exception of the Soviet Union, the two economic blocs tracked the eventual wartime division of the world into Axis and Allied powers, is almost certainly not coincidental.

In the latter part of the 1930s, in fact, two broad groups of developed countries emerged – the Western, economically internationalist, social democracies, and the Eastern, economically nationalist, dictatorships. Each “camp” differed substantially from the other, and each shared important commonalities within itself. Both the differences and the commonalities were novel. The Western nations, led by the United States, Great Britain, and France, slowly recommitted to a reconstruction of international trade, finance, and investment. Just as important, and more unusual, was the emergence of a substantial commitment to domestic programs to cushion the blow of unemployment, facilitate union organization, and incorporate labor movements into politics. The American New Deal and the French Popular Front government were merely the most prominent examples of such trends. A similar, and even more pronounced, evolution took place in Scandinavia, where Socialist governments led the way toward trade liberalization. Out of the economic carnage of the Depression emerged the beginnings of the modern welfare state, understood as the general acceptance of government provision of social insurance, basic social policies, and macroeconomic management to attempt to avoid economic volatility. This was coupled, almost everywhere, with a belief that economic cooperation among nations was desirable. Even in the United States, traditional economic isolationism seemed to have lost much of its support.

The Roosevelt administration led the British and French to a Tripartite Monetary Agreement in September 1936, which committed the three governments to mutually supporting each others’ currencies. By that point, the

rounds of mutual depreciations had roughly restored pre-1929 currency relations, and the depreciations had also allowed governments to counteract the depressing impact of falling prices. In the United States, for example, the 1933-1934 devaluation accomplished a fair amount of what its supporters had hoped, as prices and especially farm prices began to rise, the stock market revived, and industrial production recovered. Similarly encouraging signs were evident elsewhere, and when France and the gold bloc were hit by a new round of attacks on their currencies in early 1936, after the inevitable devaluations the three major Western governments acted quickly to re-stabilize exchange rates and maintain a semblance of monetary normalcy. The resulting Tripartite Agreement was applauded by free traders, international bankers, and other internationalists, and it was soon joined by Belgium, Luxembourg, the Netherlands, and Switzerland. And under America's new Reciprocal Trade Agreements Act of 1934, which allowed the executive to agree to reduce tariffs in return for reductions proffered by other countries, American trade barriers began going down almost immediately. By 1939, 22 such trade agreements had been signed, covering some 60 percent of American imports. As the Depression wound down, the West was gravitating toward general agreement on the desirability and feasibility of two goals previously seen as at odds with one another: government policies to cushion national economies, and the reduction of barriers to international trade and investment.

Not so in the the second camp, which comprised the rest of the industrial and semi-industrial world. As elsewhere, governments in Central, Eastern, and Southern Europe, and in Japan, turned adamantly inward when the terrible crisis hit. But unlike in Western Europe and North America, economic recovery did not soften the fascist rejection of the international economy. The larger fascist economies – Germany, Italy, Japan – were able to aspire to some form of economic self-sufficiency. Indeed, they brought the concept of autarky – forcible separation from the rest of the world – to economic organization, where it remained a reasonably good description of fascist attitudes toward the world economy. With autarky established, the three major fascist powers also embarked on aggressive attempts to build or enlarge colonial empires, the better to enhance economic self-sufficiency from the broader world. The smaller economies in and around Europe's fascist axis typically could not hope to be self-reliant, but they were drawn into a German-led trading system that was based on tightly controlled trade, virtually no normal financial relations, and currencies that could not freely be exchanged into other currencies (hence were "inconvertible").

Along with economic autarky, the fascist path went through severe controls on labor. Existing labor movements were wiped out, along with the socialist and communist parties with which they were affiliated. They were replaced with government-controlled "labor fronts" that told workers what their interests were, then met them. It was not so much that labor's interests were

ignored – after all, the Nazis engineered the most rapid and lasting reduction in unemployment in the industrial world – as that there was no possibility for them to be expressed independently. Fascist governments could also push businesses around if they got in the way of important policy goals, but large corporations were far better able to resist government pressures, or at least to transform them in favorable ways, than were disorganized workers. The fascist and neo-fascist political economies of Central, Eastern, and Southern Europe, and of militarist Japan, contrasted with those of the West, then, on both major dimensions. The West looked to rebuild international economic integration, while the fascists looked to protect themselves from it; the West brought powerful organized labor movements into the heart of government, while the fascists destroyed organized labor.

While semi-industrial nations in Southern, Eastern, and Central Europe and Japan moved to fascism, the semi-industrial Soviet Union and Latin America found different, non-fascist, alternatives to both pre-World War One orthodoxy and Western social democracy. The Soviets constructed their own, Communist, variant of autarky, even as they engineered the most rapid industrialization drive in history. The dictatorship of Joseph Stalin's Communist Party herded the peasantry into state-sponsored collective farms, where they were compelled to provide cheap food and raw materials for industry. All the resources of society were thrown into government-run industry supervised by a central bureaucratic apparatus under the tight control of the Communist Party. This quasi-military campaign imposed terrible hardships on much of the Soviet population, but it did succeed in leap-frogging the Soviet Union from agrarian backwardness to the first ranks of the industrialized nations.

Meanwhile, the developing regions' prior vocation of producing food and raw materials for export could not easily survive in a world in which primary product demand and prices were chronically depressed. The disintegration of the world economy hit the developing world hard, especially the collapse of primary prices and the disappearance of international loans. But as important parts of Latin America, the Middle East, Africa, and Asia were forced back on their own devices in the 1930s, they refocused their energies on national development. Urban society and modern industry grew rapidly in semi-industrial areas of Latin America and the Middle East. With them came the social and political advance of new groups and classes – businessmen, professionals, workers – that would lead these regions toward further economic development and more political democracy. Some of the more developed colonies took analogous advantage of the forced separation from metropolitan rulers to reinforce local economic and social structures in ways that would eventually help lead them toward independence.

Despite the divisions and differences, a common thread tied together all the industrial and semi-industrial countries' responses to the Depression. All of them, in one way or another, implemented some sort of “organized capitalism” –

with the obvious exception of the Soviet Union, which pursued organized socialism. Even in the capitalist world, most governments supported the formation of cartels to help stabilize prices; permitted or encouraged the coordination of wages at the industry or national level; and manipulated macroeconomic policy, even if gingerly, to affect national economic conditions. The chaos of the first few years after 1929 left their mark everywhere. And everywhere this mark pointed away from traditional *laissez faire* and toward more vigorous government involvement in the economy. The experimentation was tentative in some countries, revolutionary in others, but everywhere the way had been cleared for new approaches to new problems – and to old ones, too.

New ideas or no, the years from 1914 to 1939 were a time of overwhelming disappointment and disillusionment. In the developed world, the butchery of World War One left a hungry expectation of a return to pre-war growth coupled with a new commitment to self-determination and democracy. This optimism was demolished by hyperinflation and slump in the early 1920s, by continued conflict over war debts and reparations, and eventually by the Depression and the rise of the most undemocratic regimes in modern history. In the developing world, the recovery of the 1920s gave way to a collapse of the world economic order on which the poor regions had come to depend. While some areas did well nonetheless, others were kept – whether by the character of their societies or of their colonial masters – from either adapting to the new conditions or insulating themselves from their effects.

The interwar years, and even the Depression, were not unconditionally bleak. While the period from 1929 to 1934 was terrible, the years before and after saw rapid growth rates and substantial technological innovation. In a few parts of the world, notably Latin America, Scandinavia, and the Soviet Union, interwar economies grew faster than they had between 1870 and 1914. There were also technological reasons why the period could not be regarded as an abject failure. New productive, organizational, and managerial techniques restructured modern industry. And a plethora of previously unimaginable consumer goods came to the market, and transformed the way people – or at least people lucky enough to be in the privileged quarter of the population of the privileged tenth of industrial countries – lived.

The halting recovery, the preliminary steps at reconstituting a semblance of international economic order, the islands of growth in the midst of stagnation, and the newly available products and techniques, could not disguise the basic fact of the interwar period: the world economy had failed. It did not seem able to deliver economic growth, or stability, or protection from chaos. It did not appear associated with peace and cooperation, and may indeed have exacerbated conflicts among nations. Critics of the international capitalist system – whether fascist or communist – seemed vindicated by its inability of to overcome the

troubles of the period from 1914 to 1939. The fact that rapid economic growth was only restored with the rush to rearm was cold comfort indeed.

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- ¹ Carr (1939).
- ² Noyes (1926), pages 436-437.
- ³ Cooper (1976), page 215.
- ⁴ Cooper (1976), pages 219-221.
- ⁵ Lamont (1915), page 118.
- ⁶ Nearing and Freeman (1925), p. 273.
- ⁷ Carr (1939), page 234.
- ⁸ Figures are from Aldcroft (1977), p.128, p. 138.
- ⁹ Ernest Hemingway, "German Inflation, 19 September 1922," in *Eyewitness to History* Ed. John Carey (Cambridge: Harvard University Press, 1987), pages 497-501.
- ¹⁰ Ernest Hemingway, "Notes on the Next War: A Serious Topical Letter," *Esquire*, Sept. 1935.
- ¹¹ Meyer (1970).
- ¹² Eichengreen (1992), pages 125-152 discusses the episode; see also Costigliola (1976).
- ¹³ Nove (1969), page 94.
- ¹⁴ Aldcroft (1977), page 98 and page 102.
- ¹⁵ Maddison (1995), pages 238-239.
- ¹⁶ Lewis (1938), pages 341.
- ¹⁷ Frieden (1988), page 66.
- ¹⁸ Lewis (1938), page 377.
- ¹⁹ Aldcroft (1977), pages 238-267; see also Kindleberger (1973), pages 31-82
- ²⁰ Maddison (1995).
- ²¹ Villeda and Suzigan (1977), page 133.
- ²² The first figures are from Kindleberger (1973), page 71; the second from Eichengreen (1992), page 224. Much of the account presented here is drawn from these two essential sources.
- ²³ Friedman and Schwartz (1963), page 306.
- ²⁴ Rostow (1978), page 220.
- ²⁵ Costigliola (1972) is an excellent overview.
- ²⁶ The issue is still controversial. See Eichengreen (1989) for a rounded assessment.
- ²⁷ Eichengreen (1992), page 251.
- ²⁸ Kindleberger (1989), pages 173-178; Cain and Hopkins (1993b), pages 80-81.
- ²⁹ Rostow (1978), pages 220-223.
- ³⁰ Díaz Alejandro (1983), pages 6-11.
- ³¹ Calculated from Warren and Pearson (1935), pages 30-32, and Shaw (1947), pages 290-295.
- ³² Kindleberger (1973), page 197.
- ³³ *Ibid*, page 219.
- ³⁴ *Ibid*, page 202.