RECOVERY FROM THE DEPRESSION

Australia and the world economy in the 1930s

Edited by

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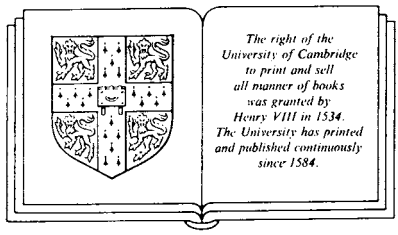

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Chapter 1

AN OVERVIEW

R.G. Gregory*

Introduction

The focus in this volume is on Australia in an international context so that we can see to what extent our depression experience was different from that of other countries with which we usually compare ourselves.[1] We begin with an overview of the depression experience in six countries —Australia, New Zealand, Canada, Japan, the United Kingdom and the United States—to provide a backdrop against which to place the individual chapters. The first task is to measure the depth of the depression in each country, focusing primarily on unemployment, employment and output. The first impression created by this exercise is the similarity of the depression experience. The economic downturn starts at much the same time (1929-30) in all countries and a strong employment recovery begins within three to five years.

Upon further investigation a number of systematic differences become apparent, especially between Canada and the United States, on the one hand, and Australia and the United Kingdom, on the other. This dichotomy is so striking, and the availability of internationally comparable data is so much better for these four countries, that the overview devotes quite a lot of space to this comparison. The major differences revolve around the depth of the depression, the date of the recovery process, the degree of job sharing and changes in the terms of trade.

After measuring the extent of these differences we change our focus towards those aspects of economic policy that attracted the attention of

*I am grateful to Jonathan Pincus who in his usual manner provided constructive comments. Alan Boxer, Noel Butlin and Mary MacKinnon also helped a great deal.

[1]There are two important volumes that provide background material for these essays. For a description of the Australian depression, see Schedvin (1970a); for data on cross-country comparisons, see Butlin (1984).

our authors. Most seem to believe, on balance, that economic policy was not an important factor which could be used to explain either the depth of the depression or the speed of recovery in their country, although there seems to be a uniformity of views that the extent of the exchange rate devaluations had some effects.

A noticeable feature of the data for each of our countries is the symmetrical nature of the depression cycle. Those countries with the deepest depression undergo the fastest economic recovery, once it gets under way. It seems to us that this is a key fact that needs to be explained, as it stands in contrast to some of the recent cycles in Australia and Europe.

In the final sections we return to the severity of the depression and discuss those chapters which focus on unmployment and income distribution in Australia.

The Severity of the Depression

Unemployment

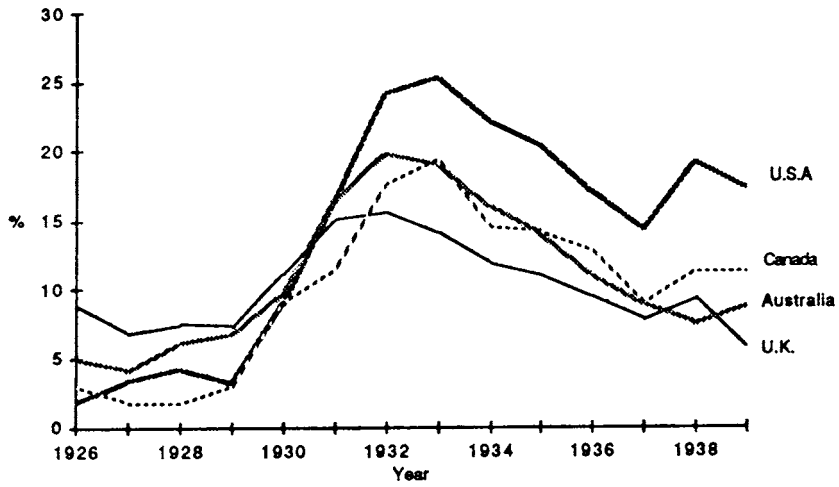
Most discussions of the depression begin with the unprecedented levels of unemployment which, by 1933, had reached 19 per cent of the labour force in Australia, 25 per cent in the United States, 14 per cent in the Britain, and 19 per cent in Canada[2] (Figure 1.1). Although the level of unemployment differed from country to country, there appears to be a fair degree of uniformity in the timing of the changes. Unemployment increases at much the same time, 1929 or 1930, reaches a peak during 1932 or 1933, and then declines rapidly, at least until 1937.

Why were the unemployment upswings so similar? The answer in part can be found in the influence of international trade. Just before the onset of the depression, exports accounted for 15 to 25 per cent of the production of five of our sample countries but much less for the United States (7.0 per cent). Although U.S. exports and imports were small relative to GDP, they were nevertheless a large fraction of world trade

[2]Consistent data series for all countries are not always available. Consequently many of the figures and tables only present data for a subset of countries.

and, as a result, fluctuations in the U.S. economy spread quickly around the world.[3]

Figure 1.1. Unemployment Rates by Country

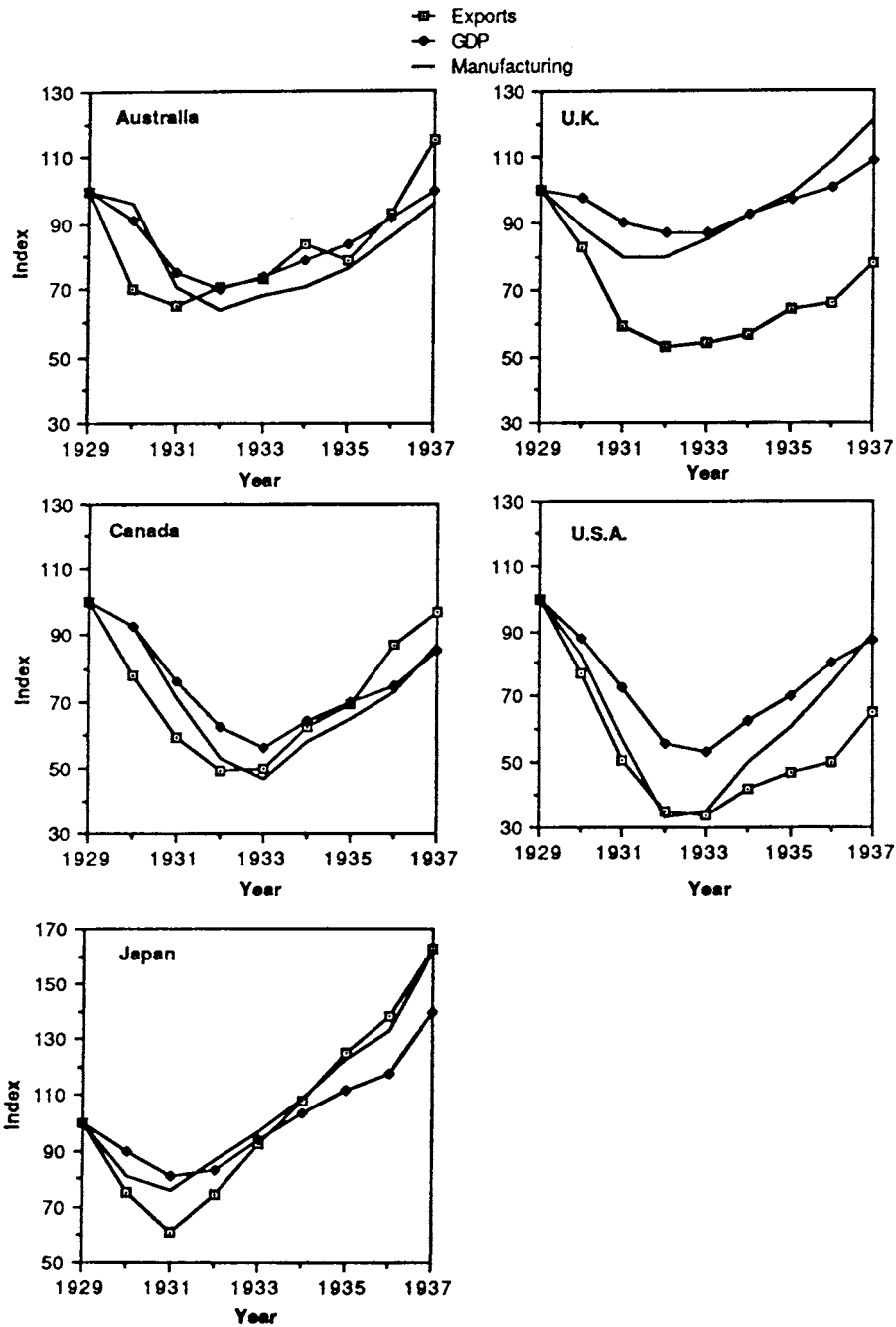


Source: Butlin (1984).

For most of the countries, and especially the exporters of primary products, it certainly appeared as though the depression arrived through the balance of payments, with sudden and dramatic falls in export demand, quickly reflected in prices and receipts (Figure 1.2). For exporters of primary products, and over the period 1929 to 1932, export prices fell by around 40 per cent. For non-primary producers the export price falls were less but export quantities slumped. For most countries export receipts as a fraction of GDP typically fell 20-25 per cent.

[3]It is really quite remarkable how economic activity is closely synchronized across the countries in our sample. It is not accepted by all writers, however, that the depression began in the United States and then spread around the world and there are some problems with this hypothesis. For example, economic activity continued to turn down in the United States during 1932 and 1933 at the same time that economic recovery had begun in many other countries. By 1934 imports into the United States, in current prices, had fallen to 35 per cent of their 1929 value and were not providing a source of growth for other economies.

Figure 1.2. GDP, Exports and Manufacturing Output, Current Prices, 1929-37



Each economy responded very quickly to the change in demand for exports. Economic activity was depressed and expenditure on imports reduced. As a result economic activity in each country tended to move together. Within three years of the initial downturn, however, economic recovery, as measured by a falling unemployment rate, had firmly begun in Australia, the United Kingdom and New Zealand. Within a further 1 to 2 years the recovery had begun in North America.

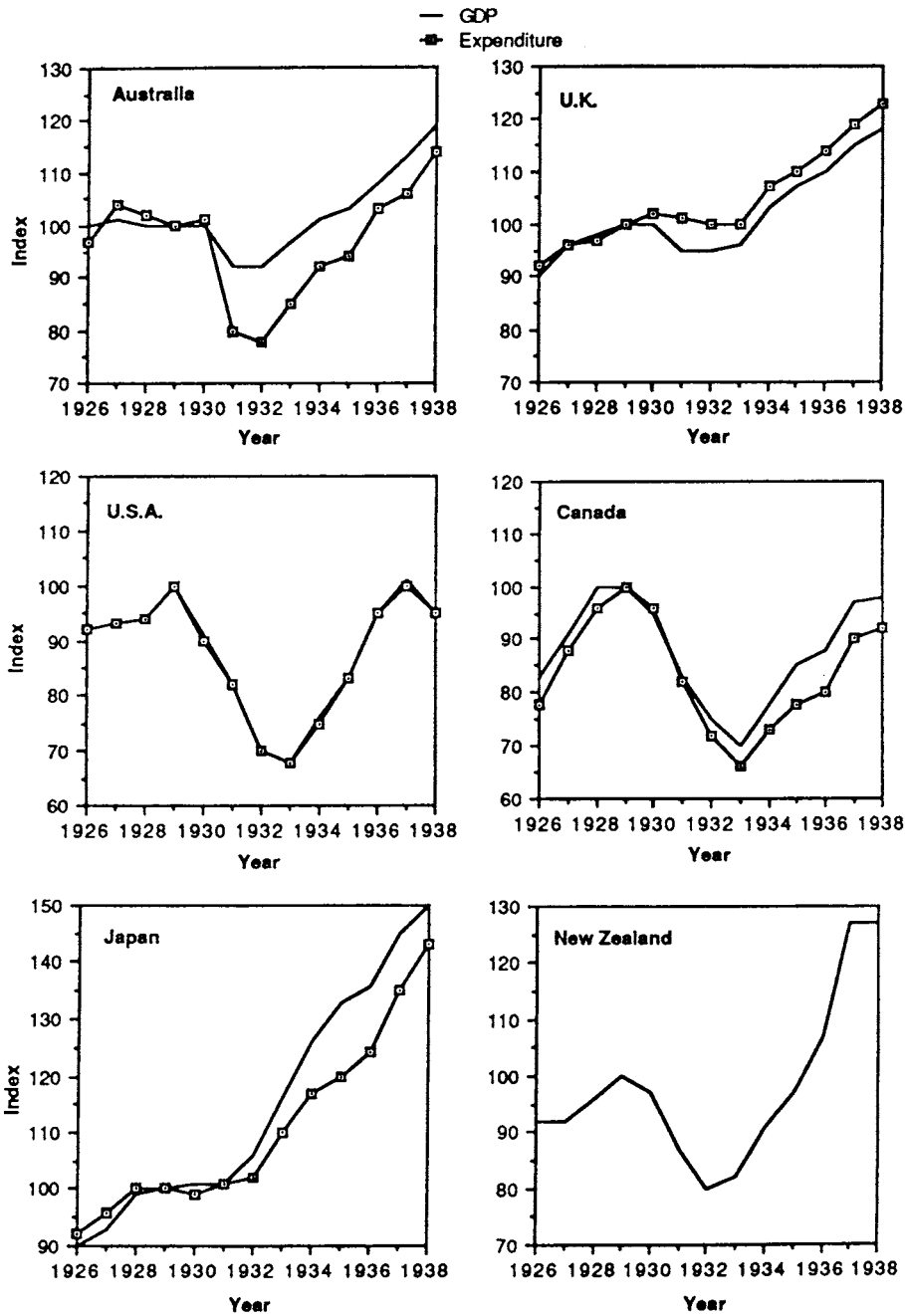
The unemployment rate in Figure 1.1 is just one indicator of the severity of a depression; apart from questions of data reliability, there are other reasons why it may not provide the best measure of economic dislocation and hardship. Three points in particular may be important. The first relates to job sharing, defined as a response to an economic downturn which involves a significant reduction in hours worked per worker rather than a fall in the number of workers employed. Where job sharing is important, the severity of the depression will be understated by our usual measures of unemployment which do not take into account hours worked. The second point relates to the role of international trade, especially where trade in primary products is important and there is a large fall in export prices relative to import prices. Under these circumstances, living standards may decline over and above those indicated by either a reduction in the volume of production or an increase in unemployment. The next two sections address these issues. The third point relates to the way in which the real incomes of fully employed workers responded to the depression. In most countries the income losses of the depression were very unevenly shared in that those who held full-time jobs usually enjoyed a significant increase in real wages. This point is discussed in the section on wages.

Job Sharing – The Relationship Between Employment and GDP

An alternative approach to using the unemployment rate as an indicator of the depth of the depression might be to compare changes in each country's aggregate production of goods and services (GDP). The pattern of GDP changes is indicated in Figure 1.3. The extent of the output loss is different in each country:

> The depression in the United States and Canada was extraordinarily deep: GDP fell by about 30 per cent between 1929 and 1933, and it

Figure 1.3. GDP and National Expenditure Indices Constant Prices (1929=100)



was not until 1937 that output returned to 1929 levels.

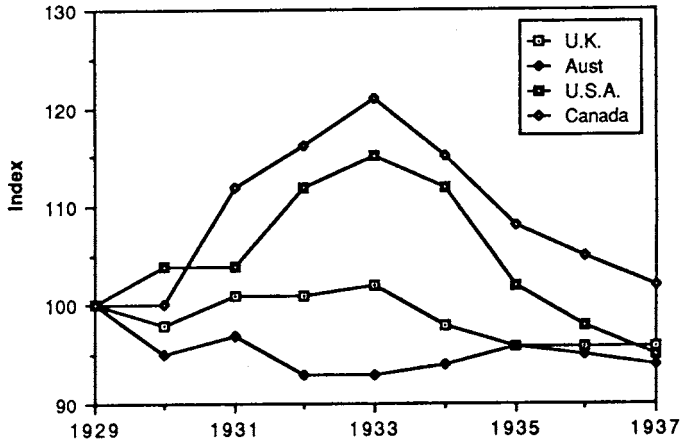
- Japan is quite different. Output did *not* fall to a significant extent; by 1932 the economy had begun on a strong growth path so that by 1938 output was 45 per cent above the level of 1929.
- Britain and Australia are in the middle ground with output falls of around 10 per cent between 1929 and 1931; by 1934 output had returned to 1929 levels.
- The New Zealand output loss lies between that of Australia and the United States.

It appears, at first glance, that the relative severity of the depression, as indicated by changes in production, accords reasonably well with the impression created by changes in unemployment; on closer inspection, however, there is evidence that the degree of job sharing differs across countries. For example, in the United States the production loss between 1929 and 1933 is *three* times more severe than in Australia, yet the increase in unemployment is less than *twice* the increase in Australia. A similar point seems to arise from a comparison of Canada with the United Kingdom.

The extent of the difference between production and unemployment changes for these four countries can be inferred from Figure 1.4 where we present the number of workers employed per unit of output. No allowance is made for changes in the number of hours worked. A very striking difference is revealed. In Australia and the United Kingdom, labour requirements per unit of output either fall significantly or do not change during the depression. This implies that there was virtually no job sharing in these countries. In Canada and the United States labour requirements per unit of output increase 15 to 20 per cent during the downswing of 1929-33 and then fall quickly during the upswing. As a result, the depth of the depression and the strength of the recovery in North America are very much greater when measured by changes in output than by changes in employment. These data imply that job sharing was very important in North America either in views of reduced hours worked per standard week, considerable amounts of short time working or extensive use of intermittent lay offs.

The importance of different degrees of job sharing across these countries can be related back to unemployment by the following simple

Figure 1.4. Labour Requirements Per Unit of Output: U.K., Australia, U.S.A. and Canada (1929=100)



calculations. If Canada had shared jobs to the same degree as the United Kingdom then, given the actual Canadian GDP experience and no changes in the labour force, Canadian unemployment in 1933 would have been 60 per cent higher and would have stood at 39 per cent rather than 25 per cent. Similarly, if Australian job sharing had applied in the United States, the American unemployment rate would have been 56 per cent higher in 1933 and would have stood at 39 per cent of the labour force rather than 25 per cent. At this stage, it is not known why these economies behave so differently or even whether this result is an artifact of the way in which the employment and production estimates are constructed. This is clearly an important area for further investigation. A start on the problem has been made in Gregory, Ho , McDermott & Hagan (1988) where the different rates of job sharing in the United States and Australia are allocated to the adjustments to labour productivity per hour worked and hours worked per week.

Terms of Trade Effects

In the rural sector the depression was felt mostly through falling prices and not through reduced employment levels. Between 1929 and 1933, rural employment increased marginally in Australia, did not fall significantly in the United States and dropped only 4-5 per cent in

Canada; but despite maintaining employment, the rural sector and workers lost considerable fractions of their incomes.

The rural sector stands in stark contrast to other areas of the economy including manufacturing. Between 1929 and the trough, manufacturing employment fell 37 per cent in the United States, 25 per cent in the Australia and 14 per cent in Britain. The overwhelming tendency in the manufacturing sector was not to maintain employment and accept reduced income levels but to reduce employment and maintain the weekly earnings of those employed.

Since the rural sector accounts for a different share of total employment in each country—for example, 8 per cent in the United Kingdom and 23 per cent in Australia—and since the relationships between production, income and employment changes are different in each sector of the economy, there is a question whether unemployment and production changes alone can provide a good indicator of the relative depths of the depression experience.

Where international trade is a negligible fraction of economic activity, as in the United States, the large relative price falls for primary commodities redistribute income within the country, from producers of primary products to consumers. Where international trade is important and primary products are a large fraction of exports, significant income redistribution can also occur between nations: countries which export products with the greatest price falls lose income to those which import them. It is towards the redistribution of income between countries that we direct our attention.

Among our sample of primary producers, the terms of trade—the price of exports divided by the price of imports—fell most for Australia, Japan and New Zealand. Between 1929 and 1932, Australian export prices declined 38 per cent relative to import prices. The terms of trade did not change significantly for the United States, and for Britain there was an improvement of around 20 per cent.

To measure the effect of the terms of trade changes on economic well-being, we adopt the usual procedure and recalculate the GDP of each country by deflating export receipts by the import price deflator. In this way, we exclude constant price exports from production but include the volume of imports that the export receipts can buy (Table

1.1). Among our countries the terms of trade effect seems relatively unimportant, except for Australia where between 1929 and 1932 this adjustment produces a 9 per cent fall in the real value of production of goods and services, which is of approximately the same magnitude as the loss in output volume generated by the depression. By way of contrast, the terms of trade adjustment for the United Kingdom over the period 1929-33 increases the real value of production by 10 per cent. Given the close historical and trading ties between these two countries, the influence of the terms of trade on their relative depression experience is worth considering in more detail.

Table 1.1. GDP Adjusted for the Terms of Trade as a Ratio of Actual GDP: Constant Price Estimates (1929=100)

Year	Australia	U.K.	Canada	Japan
1929	100	100	100	100
1930	96	96	100	98
1931	92	102	99	96
1932	91	103	99	94
1933	97	110	100	92
1934	94	106	100	90
1935	97	106	100	91
1936	100	106	100	90
1937	97	103	100	92

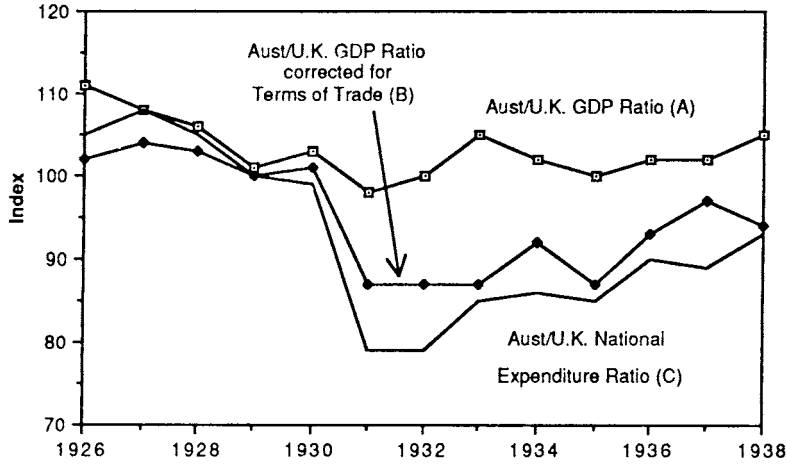
Source: Calculated from Butlin (1984).

In Figure 1.5, line A represents the ratio of GDP in Australia to that of the United Kingdom. From 1926 to 1930 Australian GDP falls almost 10 per cent relative to that of Britain; subsequently, during the depression period, the index fluctuates between a value of 99 and 105 as production in each country responds to the depression in much the same way. As indicated earlier, if we use production as a criterion, the depression seems to be about equally severe in both countries. Line B represents the GDP ratio adjusted for the terms of trade. During the 1926-30 period this adjustment offsets some of the relative fall in the Australian GDP but after 1930, there is a large fall in the the adjusted GDP for Australia relative to that of Britain and by 1931 a gap of 13 percent is created. This gap is very large and the relative improvement

in the terms of trade for Britain contributes to the large increases in the living standards of fully employed British workers relative to their Australian counterparts. From 1935 onwards, the terms of trade gradually improve for Australia but not sufficiently to re-establish the 1930 GDP relationship between the two countries.

The depression was also marked by large changes in international capital flows. In 1927-28 borrowings by the Australian government from the London capital market reached 3 1/2 per cent as a ratio of GDP and then fell away with the onset of the depression (Chapter 9). In Canada there was a similar fall in foreign investment (Chapter 4). In the United Kingdom, foreign capital outflows ceased and the reduced volume of savings accompanying the depression was redirected towards the domestic economy.

Figure 1.5. Ratios of GDP, GDP Adjusted for the Terms of Trade, and National Expenditure: Australia and the U.K. (1929=100)



The combination of the changes in international capital flows and the effects of the terms of trade has led some writers such as Schedvin (1970a) to suggest that changes in national expenditure may be a better measure of hardships and dislocation. It is clear from Figure 1.3 that expenditure variations for each country are not always the same as

production changes.[4] A comparison of the production and expenditure data across our countries suggests three important points.

First, over the depression years expenditure in Japan and Britain did not fall significantly below pre-depression levels. If we adopt the Schedvin suggestion and use national expenditure as a measure of economic well-being, it appears in *aggregate* and at least in the *short run* that the *potential* welfare of British and Japanese citizens did not fall significantly during most of the depression years. There was no significant reduction in the resources utilized. The popular image of the 1930s as a period of widespread poverty and unemployment in the United Kingdom and Japan must relate primarily to the *distribution* and *allocation* of expenditure in these countries.[5]

Second, a comparison of Australia with the United States clearly indicates the potential importance of the distinction between expenditure and production. Relative to Australia there is a 10 percentage point greater reduction in expenditure in the United States but a 22 percentage point greater reduction in production.

Third, as noted earlier a comparison of Australia with the United Kingdom indicates a similar production loss—approximately 10 per cent—but in Britain expenditure remains approximately constant while in Australia it falls about 22 per cent. Line C of Figure 1.5 plots the expenditure ratio between the United Kingdom and Australia. The gap between line B and line C is the contribution of international capital flows to the gap between the production and expenditure ratios. Between 1926 and 1930 the expenditure and production ratios are very similar; then, between 1930 and 1932, a gap of 22 percentage points emerges between the production and expenditure ratio. In terms of aggregate expenditure, Australian economic well-being falls by a very large amount. In fact, if account is taken of the declining trend since

[4]Expenditure is defined as GDP less exports plus imports.

[5]The time path of aggregate real expenditure in the United Kingdom and Japan is also reflected in per capita consumption. Over the early years of the depression, 1929-31, per capita consumption increased at an annual rate of 2.6 per cent in Japan and 2.5 per cent in the United Kingdom and in each instance the average yearly increase was only marginally less than that of the 1920s. Over the same period, per capita consumption fell 14 per cent in Australia, and in Canada and the United States over the period 1929-33 the decreases were 17 and 30 per cent respectively.