The Strange Death of Liberal Europe

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J.M. Keynes, The Economic Consequences of the Peace; On Europe in 1914

“...for [the middle and upper classes] life offered, at a low cost and with the least trouble, conveniences, comforts, and amenities beyond the compass of the richest and most powerful monarchs of other ages. The inhabitant of London could order by telephone, sipping his morning tea in bed, the various products of the whole earth... he could at the same moment and by the same means adventure his wealth in the natural resources and new enterprises of any quarter of the world, and share, without exertion or even trouble, in their prospective fruits and advantages.... He could secure... cheap and comfortable means of transit to any country or climate without passport or other formality....But, most important of all, he regarded this state of affairs as normal, certain, and permanent, except in the direction of further improvement, and any deviation from it as aberrant, scandalous, and avoidable.”
Balance of power: a Serbian kills an Austrian prince in Bosnia; Russia, unhappy, declares war on Germany, and, thus, to prevent Germany from defeating France, New Zealanders land in Turkey.

Proximate cause was the killing of Archduke Franz Ferdinand of Austria in Sarajevo, Bosnia.

Dispute with Serbia, escalation with Russia.

France and the United Kingdom are swamped by events.

In particular, the liberal government of Asquith in the United Kingdom hesitates.
John Alfred Spender, recalling a conversation with Sir Edward Grey.

“I had two short talks with Grey during the "twelve days." I ran into him on the stairs of the Foreign Office on Saturday, August 1st [...] I saw him again late in the evening at his room at the Foreign Office on Monday, August 3rd, and it was to me he used the words which he has repeated in his book, "The lamps are going out all over Europe, and we shall not see them lit again in our lifetime." We were standing together at the window looking out into the sunset across St. James’s Park, and the appearance of the first lights along the Mall suggested the thought.”
Structural reasons

- Any other cause might have delivered the same result: Moroccan quarrel, the Bosnian crisis, and then again the Moroccan question.

- Germany rolled the dice one time too many.

- Russia and Serbia, however, should also share an important part of the blame.

- Alternative explanations?

- First modern, total war.
Germany in 1914

- Political system under intense pressure:
  
  1. SPD vote in 1912 elections to the Reichstag.
  
  2. Budget deficit and federal constitution.
  
  
  4. Extreme nationalism of middle and upper class.

- In July 1914, a small elite in Germany and Austria-Hungary decides to trigger a general war.
"[W]e all consider the German character of the East as something that should be protected, and that the economic policy of the state should enter into the lists in its defense. Our state is a national state, and... we have a right to make this demand...

Certainly the vulgar conception of political economy is that it consists in working out recipes for making the world happy... However... [reality] prevents us from imagining that peace and happiness lie hidden in the lap of the future, it prevents us from believing that elbow-room in this earthly existence can be won in any way than through the hard struggle of human beings with each other...

The economic policy of a German state, and that standard of value adopted by a German economic theorist, can therefore be nothing other than a German policy and a German standard... Our successors will not hold us responsible before history for the kind of economic organization we hand over to them, but rather for the amount of elbow-room we conquer for them in the world..."
Failed reconstruction

- After four years of war, Central powers collapsed rather quickly.

- German, Austria-Hungarian, Ottoman and Russian empires disappear.

- Allies organize a peace conference in Versailles:
  1. Decide what to do with Germany.
  2. Reorganize the world political system.
  3. Reorganize the world economy.
The Treaty includes no provisions for the economic rehabilitation of Europe, –nothing to make the defeated Central Empires into good neighbors, nothing to stabilize the new States of Europe, nothing to reclaim Russia; nor does it promote in any way a compact of economic solidarity amongst the Allies themselves; no arrangement was reached at Paris for restoring the disordered finances of France and Italy, or to adjust the systems of the Old World and the New.

The Council of Four paid no attention to these issues, being preoccupied with others, –Clemenceau to crush the economic life of his enemy, Lloyd George to do a deal and bring home something which would pass muster for a week, the President to do nothing that was not just and right. It is an extraordinary fact that the fundamental economic problems of a Europe starving and disintegrating before their eyes, was the one question in which it was impossible to arouse the interest of the Four. Reparation was their main excursion into the economic field, and they settled it as a problem of theology, of polities, of electoral chicane, from every point of view except that of the economic future of the States whose destiny they were handling.
Clemenceau was by far the most eminent member of the Council of Four, and he had taken the measure of his colleagues. He alone both had an idea and had considered it in all its consequences. His age, his character, his wit, and his appearance joined to give him objectivity and a, defined outline in an environment of confusion...

He felt about France what Pericles felt of Athens –unique value in her, nothing else mattering; but his theory of politics was Bismarck’s. He had one illusion –France; and one disillusion–mankind, including Frenchmen, and his colleagues not least. His principles for the peace can be expressed simply. In the first place, he was a foremost believer in the view of German psychology that the German understands and can understand nothing but intimidation, that he is without generosity or remorse in negotiation, that there is no advantage be will not take of you, and no extent to which he will not demean himself for profit, that he is without honor, pride, or mercy. Therefore you must never negotiate with a German or conciliate him; you must dictate to him. On no other terms will he respect you, or will you prevent him from cheating you.
The President was not a hero or a prophet; he was not even a philosopher; but a generously intended man, with many of the weaknesses of other human beings, and lacking that dominating intellectual equipment which would have been necessary to cope with the subtle and dangerous spellbinders whom a tremendous clash of forces and personalities had brought to the top as triumphant masters in the swift game of give and take, face to face in Council...

He not only had no proposals in detail, but he was in many respects, perhaps inevitably, ill-informed as to European conditions. And not only was he ill-informed—that was true of Mr. Lloyd George also—but his mind was slow and unadaptable. The President’s slowness amongst the Europeans was noteworthy...

He did not remedy these defects by seeking aid from the collective wisdom of his lieutenants. He had gathered round him for the economic chapters of the Treaty a very able group of business men; but they were inexperienced in public affairs, and knew (with one or two exceptions) as little of Europe as he did, and they were only called in irregularly...
Somehow surprisingly, the world experienced a prosperous decade in the 1920s.

Large increments in productivity.

Electricity, cars, radio, housing, etc.

Large capital flows between the U.S. and Europe.

By around 1928, Keynes' worst nightmares looked too pessimistic.
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Great Depression

- On the summer of 1929, the U.S. economy enters into recession.

- Black Tuesday (October 29, 1929) signals the start of the collapse of the stock market.

- Quickly, the collapse in economic activity extends worldwide. Credit Anstalt, in Austria, was revealed to be bankrupt in May 1931.

- Worst recession ever, changed the world.
Why?

- One of the most disputed issues in macroeconomics.

- The answer to the question colors our understanding of how to conduct economic policy.

- A relatively “mainstream” view: a severe, but not exceptional recession was transformed into a great depression by policy mistakes.

- Some of those were avoidable: the behavior of the Federal Reserve System in the U.S. (Friedman and Schwartz, A Monetary History of the U.S.).

- Some of those were unavoidable: came from the world economic organization created by Versailles.
<table>
<thead>
<tr>
<th>Year</th>
<th>Sterling bloc countries</th>
<th>Gold bloc countries</th>
<th>Exchange Controls</th>
<th>Others with Depreciated Currencies</th>
</tr>
</thead>
<tbody>
<tr>
<td>1929</td>
<td>Argentina, Australia</td>
<td></td>
<td></td>
<td>Canada, Brazil, Spain, Uruguay</td>
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<tr>
<td>1930</td>
<td>New Zealand</td>
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<td>Peru, Turkey</td>
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<td>1931</td>
<td>Denmark, Egypt, Finland, Norway, Japan, India, Sweden, United Kingdom, Portugal, Thailand</td>
<td>Austria, Bulgaria, Czechoslovakia, Denmark, Germany, Hungary</td>
<td>Colombia, Mexico</td>
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<tr>
<td>1932</td>
<td></td>
<td>Romania</td>
<td>Chile, Greece</td>
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<td>1933</td>
<td>South Africa</td>
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<td>Cuba, United States, Philippines</td>
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<td>1934</td>
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<td>1936</td>
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<td>France, Netherlands, Switzerland</td>
<td>Poland</td>
<td>Indonesia</td>
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</tbody>
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Note: Year of departure from the gold standard for columns 1, 2, and 4. Year of imposition of exchange controls for column 3.
A. Volume of World Trade and World GDP

![Graph showing measures of World Trade and World GDP from 1924 to 1938. The graph includes two curves: one for World Trade and one for World GDP. The data is sourced from the League of Nations (1939c), Appendix III, and Maddison (2006).]
B. Manufactured Goods: Volume of World Trade and Production

![Graph showing the volume of world trade and production for manufactured goods from 1924 to 1938. The graph plots production and trade levels against time, with the year 1929 set as 100. During the early 1930s, both production and trade experienced significant declines, but recovery began in 1935. The data is sourced from the League of Nations (1939c), Appendix III, and Maddison (2006).]
Figure 2: Average Percentage Tariff Rate on Imports, various countries, 1928, 1935, 1938

Source: see text.
Industrial production, 1929=100
Responses: U.S.

- Hoover administration tries to keep wages high. Why?
- Roosevelt’s New Deal.
- Large package of measures.

First New Deal:
2. Glass–Steagall Act: FDIC.
3. Gold Reserve Act. $20.67 per troy ounce to $35.
4. TVA, CCC,...

Second New Deal:
1. Social security.
2. National Labor Relations Board.
Figure 1 - Industrial Output and Hours
(Sept 1929 = 100)
Figure 2 - Manufacturing Employment and Hours per Worker
(Sept 1929 = 100)
Figure 3 - Manufacturing Wages
(Sept 1929 = 100)
Responses: Other countries


- France: initial reluctance to change, victory of Popular Front in 1936.

- Scandinavian countries.

- Latin America countries.

- Germany, Italy: false hopes...