ECONOMIC HISTORY READINGS

Class 15

H A N D O U T

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This material has been made by students of other classes who have not followed online lectures and two readings are missing.

READINGS FOR THE FIRST PARTIAL

Allen, R. C.; Global Economic History, Chapter 1, "The Great Divergence"

Overview

Main topic: Why did the Industrial Revolution happen in Britain, in the eighteenth century?
Theories talk about:

- Technological change as the immediate cause of growth: steam engine, the cotton spinning machinery, and the manufacture of iron with coal and coke
- invention on this scale was unprecedented, and it inaugurated an era of industrial expansion and further technological innovation that changed the world
- Consequences of technology: rapid urbanization, capital accumulation, increases in agricultural productivity, the growth of income

Allen's explanation two parts:

1) Expansion of the early modern economy (1500-1750): unique structure of wages and prices in 18th century Britain.
    1. Wages remarkably high
    2. Energy remarkably cheap
2) Industrial revolution: Steam engine, the water frame, the spinning jenny and the coke blast furnace increased the use of coal and capital relative to labor.
    1. adopted in Britain because labor was expensive and coal was cheap, and they were not used elsewhere because wages were low and energy dear
    2. Invention was governed by the same considerations
    ➔ The Industrial Revolution, in short, was invented in Britain in the eighteenth century because it paid to invent it there, while it would not have been profitable in other times and places.

End of industrial revolution (1830/1850): railroad and steamship and then novel manufactures like Bessemer steel appeared on the scene.

- The cotton mill and the coke blast furnace were invented in Britain because they saved inputs that were scarce in Britain and increased the use of inputs that were abundant and cheap. For that reason, these techniques were not immediately adopted on the continent or anywhere else in the world
- Landes (1969): period up to 1850 = "continental emulation" → French, Germans and Belgians were only beginning to use British techniques and pre-industrial practices remained dominant

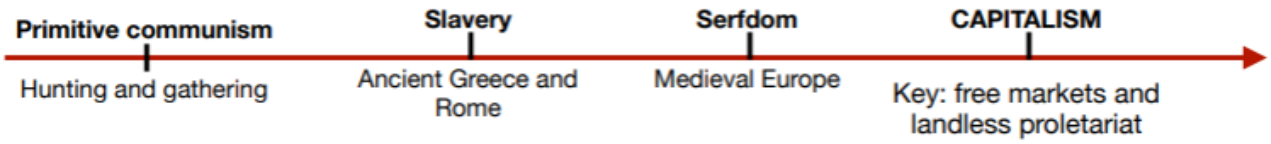
Closing gap (1850-1873): modern technology displaced traditional methods, and European industry could compete on an equal footing with British

- British engineers studied the steam engine and the blast furnace and improved them in order to lower costs → profitable to use new technologies everywhere.
- By the middle of the nineteenth century, the genius of British engineering had improved the technologies, thereby eliminating the competitive advantage they had given Britain.
- Global diffusion marked the end of the Industrial Revolution

Explaining the Industrial Revolution

Social structure

Marx: stress the importance of social structure
Society evolved through stages:



Markets are necessary to guide economic activity, and the bulk of the population must lose its medieval property rights so that it is willing to move to the cities and for agricultural productivity to grow.
Since Marx, new discoveries about medieval world:

- Studies of grain prices show that markets were wide- spread and as efficient as they were in the eighteenth century
- Economy of cities and towns was vibrant and commercial
- Cropping patterns were responsive to environmental and commercial opportunities, and productivity was much higher than once believed

BUT:

- For most of the middle ages, a majority of the English were serfs and held land in villeinage (could only litigate in the manorial courts presided over by their lords)
- no secure public protection against violence by their lords
- subject to a variety of assessments that reduced economic incentives
- Labor mobility was inhibited, since a serf could not leave the estate without permission
- Tallage: assessment initially to random the lord, but convenient and elastic revenue source that became routine.
- ➔ The emergence of capitalist institutions was a necessary, if not a sufficient, condition for modern economic growth.

Constitution and property rights

Liberals → favor "minimal government" → parliamentary checks on the executive, the security of property rights, the flexibility of the legal system.
Glorious Revolution of 1688: consolidated parliamentary ascendancy, limited royal prerogatives and secured private property.
→ favorable climate for investment → Industrial revolution
Critiques: - No banking and interest structural break → ↑investments were not manifest in finance

- UK property rights were at least as secure in France (almost too secure: some projects only undertaken after French Revolution → power to national assembly)
- Taxes were higher in Britain than across the Channel

The Scientific Revolution (17th Century)

- Started in Italy with Galileo and ended in England with Newton
- 'Naturalists' could benefit the economy by inventing new products and solving production problems - Boyle (1671): possibility of inventing engines to mechanize production
- While a lot of historian don't believe it, scientific discoveries underpinned important technology in the Industrial Revolution

Critique:

- Scientific discoveries that mattered for the Industrial Revolution were made before 1700 and not after 1760.
- Most important: atmospheric pressure related (weight, possibility to condense it to form a vacuum)
    - Culmination: Thomas Savery's steam pump invented in 1698 and Thomas Newcomen's steam engine of 1712.
- Discoveries of seventeenth-century physics were necessary conditions for the invention of the steam engine, but they were not sufficient
- Turning the scientific knowledge into working technology was expensive → worthwhile investment only in Britain where high demand for drainage thanks to coal.

Superior rationality?

Max Weber:

- Modern people are characterized by their superior rationality, The Protestant Ethic and the Spirit of Capitalism (1904–5) → Reformation let to Western rationality → Great Divergence
- Low agricultural productivity in less developed countries because of farmers' irrationality.
- Response to changes in agricultural prices and their willingness to adopt new techniques → same rationality level in developed and non countries.

Science as culture

Max Weber:

- A scientific attitude had to replace superstition for technological progress to occur
- Pre-modern people attributed events in the natural world to the interventions of supernatural beings
- Influence of spirituality stood in the way of the empirical, scientific outlook necessary for technological and social progress.
- Need for "the disenchantment of the world" → world as a material realm → focus on discovering its empirical regularities and natural laws → Technological development

Why did the West give up superstition?
Jacob (1997): Scientific Revolution transformed popular culture. → widespread interest in science → change of human nature.

- New person: generally a male entrepreneur who approached the productive process mechanically → mechanization of production
- Britain's lead over France was due to 'the marked differences in the scientific cultures found in Britain in comparison to France or the Netherlands'.

Why? Brits first smelted iron with coke, invented the steam engine, and discovered how to spin with machines.
Mokyr: Enlightenment connects the Scientific to Industrial Revolution. → "Industrial Enlightenment":

- application of the scientific and experimental methods to the study of technology
- belief in an orderly universe governed by natural laws that could be apprehended by the scientific method
- expectation that the scientific study of the natural world and technology would improve human life
- Industrial Enlightenment was more fully realized in Britain than on the continent.
- Easier and more fruitful communication between savants and fabricants
- Britain was more abundantly supplied with skilled mechanical artisans than France, so it was easier for engineers to realize their inventions

Scientific worldview influenced the second and third tiers of inventors critical for the elaborating and applying breakthrough technologies.
Jacob (1997): even factory operatives had to become Newtonians → mechanical knowledge needed for invention and effective exploitation of mechanical devices.

- Knowledge spread though provincial 'scientific societies, academies, Masonic lodges, coffee house lectures' etc.

Between 1500-1800: two gradual but important changes in popular attitudes → secularization and politicization.

- Growing concern of creating a better life in this world
- Pursue of Wealth and status as sign of salvation (Weber)

Culture and the economy: cause or effect?
Three cultural evolutions thanks to economic changes:

- spread of literacy and numeracy (with urbanization) : cities, rural industry and commerce required more skills + printing reduced price of books → more reading for pleasure. Arithmetic studied for its utility (ship commerce)
- Emergence of consumerism (for work)
- Postponement or deferral of marriages when it was economically convenient

→ big steps in the emergence of modern men and women.
18th century level of human capital is an important reason why Industrial Revolution didn't happen before.

Consumerism and hard work

- evolution of the economy also increased the incentive to work hard → availability of new consumer goods → people want income.

Mathias and De Vries: 'industrious revolution' → Steuart's "Men are […] slaves of their own wants"

- New consumerism: necessary but not sufficient to explain economic progress. → pursuit of income to buy novel consumer goods (often coming from abroad thanks to globalization) = cultural basis for industrial revolution.

Marriage and Children

Northwestern Europe developed a distinctive pattern of marriage that contributed to high living standards and a broader sphere of personal independence.
Hajnal (1965): line from St Petersburg to Trieste → on the East and South all women married, most in their teens. On the West and North 1/5 never married and most who did waited until their twenties. S-E pattern: high fertility and low living standards
N-W → European marriage pattern: low fertility and high standard of living → facilitates savings and economic growth.
Malthus: standard of living of most people was higher in England than in China because the English deferred marriage when incomes were low.
Why EMP?

- high wage economy after the black death.
- strong demand for labor → young women could support themselves apart from their parents and control their lives and marriages

The emergence of modern culture

- Culture possibly became more secular and more concerned with economic success
- Chase after new products
- Rise of modern attitudes

An economic approach to the Industrial Revolution

- Focus on demand for new technologies
- Britain's high wages and cheap energy increased the demand for technology by giving British businesses an exceptional incentive to invent techniques that substituted capital and energy for labor.
- Population at large was better placed to buy education and training than their counterparts
- High rates of literacy and numeracy contributed to invention and innovation

Habakkuk's (1962): American inventions had a labor-saving bias that accelerated the growth in output per worker→ attributed high wages → economize on labor
Abundance of land and natural resources → high wages

The transformation of the European economy, 1500–1750

Middle-Age:

- European manufacturing and commercial center was the Mediterranean (+Belgium)
- Most of British population lived in countryside → agriculture. Low productivity and income.

16th - 18th century:

- By the 18th, the economic center of gravity shifted to the North Sea.
- In the 16th and 17th century: Dutch Republic pulled ahead
- By the 17th century: British incomes pushed past France and the Habsburg Empire.
- By the 18th century: Britain overtook the Dutch

→ Reconfiguration of European economy was precipitated by increase in international Trade –

- 16th-17th: shift in location of cloth production → North Sea
- 17th-18th: intercontinental trade expansion → English and Dutch established world empires (manufacturing and commerce)
- Spanish → acquired Latin American Silver → inflation → uncompetitive production

1500: share of agriculture was for many about 75% (similar to the one of less developed in 20th century)
1500-1800: agriculture shares decreased. (England biggest drop, Spain least). Poland and England had biggest urban revolution.
Note: because of data availability countries are defined in terms of modern economy, but artificial since many of the countries were fragmented.

1500: Europe was a backward economy (3/4 of people in agriculture in England, Austria-Hungary, Germany, France and Poland). Small cities (<10% of population): 50000 people in London. Limited nonagricultural employment. Leading economies: Italy, Spain and Belgium (with a 19-30% urban fraction) → Agricultural revolution in England → rise in both urban and non-rural → Protoindustrialization

- In many parts of Europe, manufacturing industries developed in the countryside (production in workshops or at home)
- Merchants signed up rural residents as piece rate workers, brought them raw materials and collected the finished products → sold to other merchants who shipped them to the rest of Europe.
- Regions were intensely specialized (Woolen Cloth: Norwich and West Riding Yorkshire, metal buttons fitting and implements: Birmingham, stockings: Leicestershire, blankets: Oxford.

- The expansion of rural industry in northwestern Europe was associated with the emergence of new economic leaders because it came at the expense of established producers
- Dutch and English's clothes became the "new draperies"
- England successful: Black Death → fall in population → reversion of much good farmland to pasture → feed supply for sheep → their wool was longer and better suited
- Refugees from the continent brought skills that improved the quality and variety of English products

Early Modern England:
- Improvement of agriculture → tax countryside income and spent it on urban and naval areas → Rapid urbanization
- Some of the urban growth was due to manufacturing; London center of English publishing and furniture-making
- Most of the growth of cities was due to trade and commerce (intra-European trade was the basis of London's expansion)

16th century: Portugal most successful European Power in South Asia: spice trade and colonies.
Early 17th: Netherlands took "spice islands" from Portugal establishing Indonesian Empire → Amsterdam = wholesaling center for tropical produce. Trade with India → + tea + cotton

Early modern Low Countries:
- Second most successful economy
- Less than 1/2 of population was engaged in agriculture and urban and non-agricultural shares were high - Flanders (Belgium) had been highly urbanized and a leading manufacturing center in the middle ages.

Dutch Economy:
- Most advanced in the 17th: agricultural revolution → growth of urban and manufacturing economies.
- New draperies, manufacture of light cloth
- Manufacturing and rural industry were also formidable - English only overtook Dutch in late 18th

Rest of continental Europe (North of Alps and Pyrenees):
- France and Austria were major military powers
- Poland was united in 1500 but dismembered in the next three centuries
- Germany remained divided into many states throughout the period
- Prussia: international actor
- Modest development in early modern period
- Agriculture shares dropped to 60% (similar to Italy and Spain in 1500)
- Rise in proto-industry share
- Important rural manufacturing industries
- Urban shares scarcely increased → sets them a part from England and Low Countries.
- For a time, the French had some valuable colonies, but they were lost in the Seven Years War and the Revolution.

Spain and Italy:
- Absence of structural change between 1500 and 1800.
- No movement in the end of middle-age lager urban and small agricultural shares.
- Absence of growth in rural manufacturing → no proto-industrialization
- Italy no foreign possession, Spain yes but only brought inflation.

From early modern expansion to Industrial Revolution

- Industrial revolution = result of long process of social and economic evolution running back to the late middle ages.
- Commercial and imperial expansion of Britain was a fundamental feature of this evolution, but not its totality.

➢ Black Death: population fall increased labor mobility by generating many vacant farms, and that mobility undermined serfdom.
➢ High wage economy: benefits of high consumption were not confined to people: sheep ate better as well → better wool → "new draperies" → exports
➢ London growth: rapid growth in the city's population and the rise of the coal industry to provide the capital with fuel.
➢ Trade boom: extended to the Americas and Asia in the 17th and 18th centuries by England's mercantilist expansion of trade and acquisition of colonies.
➢ Larger cities: advances in agricultural productivity, division of labor, greater efficiency and higher wages.

The expansion of the early modern economy was underpinned by favorable institutional and cultural developments.

- End of serfdom + establishment of a stable legal environment → capitalist enterprise → growth
- Gradual decline in superstition and medieval religion → rise of a scientific attitude → research for practical solutions
- Demand for trade and drop in book prices → spread of numeracy and literacy.
- New products (from abroad) → ↑ aspiration to consume → ↑ incentive to work and earn higher incomes

Upshot of the commercial expansion: unique wage and price structure in England in the 18th High wages and cheap energy → incentives to invent technologies that substituted capital and coal for labor → inventions → Industrial revolution
Evolution of law and culture → favorable supply response → international expansion → Industrial revolution.

Mokyr, J.; "The European Enlightenment, the Industrial Revolution, and Modern Economic Growth," Max Weber Lecture Series

Two fundamental assumptions are taken for granted about the Great Divergence:

1) Modern economic growth started in western Europe (i.e. selected economies in the northern Atlantic region);
2) Britain was a leader in this process and continental Europe a follower (albeit a rather quick one).

The assumption debated is that countries in 1914 were part of the Convergence Club were also subject to the European Enlightenment. The Enlightenment affected the economy through two mechanisms:

1) The attitude towards technology and the role it should play in human affairs;
2) Institutions and the degree to which rent seeking and redistribution should be tolerated.

The Enlightenment changed the outlook of key persons on their natural environment, and their inventions and discoveries turned what might have become another technological example of development into a huge change starter in economic growth. The importance of the Enlightenment to the subsequent economic development of western Europe is consistent with both the temporal and geographical pattern of growth but such correlation alone doesn't constitute proof of the link between the Enlightenment and the Industrial Revolution.

The industrial revolution and modern growth

The Industrial Revolution (in its classical definition: a counterfactual technological/technical evolution that emerged between 1750 and 1800) did not suffice to generate sustained economic growth. The change that went with it was the approach to this technological evolution. Before 1750 many path breaking inventions were made and engineering existed well before then, but prior to the Industrial Revolution all the techniques in use were supported by very narrow epistemic bases.
This lack doesn't mean that improvement was not possible (it was, especially through trial and error) but it made much more slow and costly the subsequent adaptation and development so that economic growth is not

sustainable (because if I don't understand how something works, how can I effectively ameliorate that?). Yet scholars found it difficult to link the main technological breakthroughs of the Industrial Revolution to the scientific discoveries of the time. The solution to this can be divided into:

1) Timing: while the first advances of the Industrial Revolution (in the period between 1760 and 1800) were weakly based on science, in the subsequent momentum they increasingly became to depend on the better understanding of the propositional knowledge underlying the inventions;
2) Epistemic base of inventions doesn't only include a modern definition of science but a broader definition of knowledge including simply catalogues of phenomena and irregularities that could be relied upon even if the underlying processes were not quite understood.

Growth was possible through capital accumulation, increasing trade, freer markets, etc. but all of these would eventually run into diminishing returns: is technology that remains at the foundation of modern economic growth. The fundamental assumption of the Enlightenment, then, was that the growth of useful knowledge would bring prosperity: the expansion of useful knowledge would solve technological problems and that the dissemination of knowledge to more and more people would attain substantial efficiency gains.
Not all was abstract science (e.g. Laplace and Lavoisier's findings), but it was clear that growth had to be carried out collectively through a "division of labor" in which specialization was carried out at levels far higher than before. Over the 18th – 19th century the interaction between propositional ("what") and prescriptive ("how") knowledge became much tighter: it's this phenomenon that prevented the fallout of the Industrial Revolution and enabled it to become the base point of modern growth.

The enlightenment and technological progress

The Enlightenment had the assumption that society was improvable and that the process by how this could be attained can be summed up into four headings:

1) Agenda the "Baconian program" ("produce innovations of which nature unaided is not deemed capable" – Zagarin, 1998) served as the key agenda of researchers at the time. The already stated idea was that knowledge was supposed to be useful and society was improvable by it. Supposedly, it had to help in solving practical problems and to satisfy human curiosity. Consequently, many 18th century scholars known for their contributions used their insight to attack problems of production even though the connection between the discoveries to science is not always apparent. Description and organization mattered as much as everything else, as Bacon had argued: many investigations of the century followed the "three Cs" rule (counting, cataloguing, classifying). In this way, information recorded couldn't be lost and could be passed on;
2) Capabilities the scientific revolution advanced in part because of the existence of new tools – such as the telescope, the barometer and the air pump – that allowed new experiments and observations possible. Another increased capability came from mathematics: advances in maths added new instruments – such as mathematical functions – useful in engineering, ballistics, navigation, etc.;
3) Selection innovative ideas were selected from the broader pools of ideas proposed to the people, which was a new concept introduced thanks to the Enlightenment. Knowledge and beliefs were regarded as contestable at every level and tolerance was raise to the level of principle (inquisition and other historical methods of censorship weren't present in the countries interested, or were in minor part). Free entry into the market of ideas and the absence of repression were a high priority on which all Enlightenment thinkers were united. In addition to this, two main check systems for ideas were introduced, on which the new scientific selection criteria were based:
    a. ex ante selection (i.e. peer review before wide publication of a theory), by which successful ideas at the time were a result of signaling of credible "reputation" as a scientist/researcher among equals,
    b. ex post selection, by which all theories available to the public were always further debatable;
4) Diffusion knowledge resembles a contemporary open source technology. Open science was key to the rapid changes in the market for ideas because its purpose was, exactly, to disseminate new concepts and offer them to the marketplace. Knowledge is a non-rival good and, in theory, the source can share it costlessly. In practical terms, costs of access were made up by costs of diffusion (higher than today).

Those costs were, by all means, brought down drastically by the usage of paper, printing and the telegraph, as well as by improvements in transportation and postal services. Moreover, newly born encyclopedias were an important factor in spreading knowledge, as well as places such as coffee houses, societies and academies which sold culture freely to the public.

Intellectual property rights and the enlightenment

It was recognized that invention was costly and risky (because of time consumption and unpredictable returns on investments), and if that society wanted to generate a continuous stream of technical improvements, it had to make the activity that generated innovation financially attractive. Moreover, knowledge is a non-excludable good, therefore some might have wanted to keep secrecy on inventions as to avoid others exploiting them. The patent system was deemed a solution to these adverse factors because:

- it protected intellectual property rights by asking a fee for usage and recognizing paternity of an idea;
- it eliminated secrecy with the obligation to divulge the existence of the invention, once patented.

Eichengreen, B. [1992]; "The Origins and Nature of the Great Slump," *Economic History Review*, Vol. 45, No. 2, pp. 213-239

One of the most enduring themes in research on the Depression is that changes in economic structure during WWI and the '20s were responsible for the crisis of the '30s. Four variants of the same hypothesis have been made in regard:

1. 1) Production Structure. A transformation happened in the from staple trades (e.g. iron, steel, cotton) to "new industries" (e.g. chemicals, electrical engineering). The rapid pace at which it happened could have heightened cyclical instability of the economy. But not only the mechanism is unclear, also the notion that structural change was rapid between wars is questioned by research.
   Alternatively, it could have been that the direction rather than the pace of structural change heightened the economy's vulnerability. The growing importance of consumer durables was one such change, the motor car being its epitome. Data shows modest but noticeable changes in the growing expenditure for consumer durables; even though America was an exception in this, being at least ten years ahead other countries (such as the U.K.). Being consumer durables costly, their demand is sensitive to cyclical conditions1. In periods of uncertainty, households hesitate to spend on goods of limited resale value, because reliability of goods was known better by sellers than buyers and the inability to ensure that they were properly maintained made them difficult to rent. Thus, the shift in production and consumption towards durables may have heightened the sensitivity of the economy. The fact that these goods were purchased mostly on credit, helped in the process. Additionally, accompanying these changes, were the ones in primary production: Russia and East Europe's grain export was disrupted by the war, making it possible for newcomers (U.S.A., Canada, Argentina) to cut in in supply. Abundance of cheap credit fuelled a boom in farm land prices, prior to the war, although when in 1920 East European flow of grains started again and interest rates rose, commodity prices turned down and land prices collapsed. Farmers then found themselves saddled with low output prices and heavy mortgage debts.
2. 2) Labour Markets. The pervasiveness of high unemployment before the depression hints to a possible deterioration in flexibility and adaptability of labour markets. Levels of unionization reached unprecedented levels in this period: between one and two thirds of British labour force was covered by collective agreements (i.e. agreements between firms and unions). Yet, it is also true that, after WWI, levels of union density declined: the vast majority of workers by then was not covered by this kind of agreements. There is little evidence outside the U.S. of a change in wage determination process. Still, these high levels of unionization brought to an enlargement of the welfare state available to the workers: as macroeconomic models suggest, the new welfare system brought down the employment rate and decreased the production capacity levels of the country;
3. 3) International Payments. In an international lending cycle, U.S. became the dominant source of capital exports making Europe turn from creditor to debtor. Primary producers, then, bought manufacturers from the U.S. and all the investments made in Europe were financed by American capital exports. There was therefore European dependency on U.S. demand: if Fed deflates, U.S. import demand falls, and U.S. capital stays at home;

4. **Conservative Monetary Policy.** During the depression, monetary and fiscal policy pushed for austerity instead of expanding aggregate demand.

U.S. restrictive monetary policy seems to have significantly contributed to the onset of the slump. On a global perspective, the introduction of the policy coincided with the movement of gold towards France. Thus, as France and U.S. siphoned gold from the other countries, foreign central banks were forced to raise their discount rates and to restrict the provision of domestic credit in order to defend their gold parities. Superimposed on already weak foreign economies, the progressive changes in restriction in French and American policy produced a magnified shift in monetary policy in all other countries, therefore having such an impact as to start a crisis. With central banks clinging to the Gold standard and to the restrictive policies required for its defence, economic activity weakened: recessionary tendencies were evident in Germany, Argentina, Brazil, Australia, Canada and Poland even before the slump surfaced. Then, the question is why U.S. economy precipitated so fast:

1. 1) Deterioration of U.S. **export markets** (seen above);
2. 2) The **1929 Stock Crash**: the rise in stock market volatility initiated a new trend of uncertainty that may have impacted greatly on consumers' faith in expenditure.

The decline in U.S. economic activity was transmitted to other countries through several mutually reinforcing channels, and they operated powerfully because national economies were linked together by fixed exchange rates of the gold standard. Inter war gold standard was dysfunctional, promoting worldwide deflation. It can be said that recovery started when first Britain then the U.S. left the Gold Standard.
Still, until 1914 it worked well: sterling was 'just as good as Gold', no actual shipment of bullion was required for reserves; Britain had huge current account surplus and also managed to export capital; major central banks cooperated to avoid running out of reserves; gold supply increased rapidly, mostly from U.K. dominions.
During the inter war period, though, things changed:
• U.S. had huge current account surplus, but sterilised it;
• Weak credibility of peg in other countries and consequent switch to gold
• Accumulation of gold reserves in U.S. and France, shortage of credit in the world economy: no effective gold exchange system;
• Major central banks did not cooperate to alleviate gold hunger.
There are two main reasons as to why the situation after WWI changed:

1. 1) **Incorrect Exchange Rates**
    1. U.S. return to pre-war parity *overvalued the dollar* against gold by 35%;
    2. There was *insufficient gold cover*, therefore the Federal Reserve had to accumulate gold by sterilising export surplus;
    3. Other countries returned to gold on too high (U.K.) or too low (France) parities, leading to *large trade imbalances*;
2. 2) **Misallocation of Gold**

a. Federal Reserve and Banque de France feared the effects of inflation, so they *sterilised* gold and foreign exchange imports;

2. U.S. protected its market with *high tariffs*, thus making other countries experience current account deficits;
3. Deficit countries had only one solution to maintain parity: *deflation*.

ADD ON: UNEMPLOYMENT
Mass unemployment was largely unknown before 1914: there's quantitative evidence that before WWI unemployment was of shorter duration and only cyclical. But in the '20s, it sustained high levels (around 8.3%), becoming exceptionally high in the '30s (15.8%). There are two interpretations as to why unemployment rate became so high:
1) **The classical model**, characterized by:
a. *Flexible wages and prices*;
b. Supply and demand of *labour* determine:

i. the equilibrium price of labour (i.e. the real wage),
ii. the quantity of labour supplied;

c. *No involuntary unemployment*, because everyone who is looking for a job paid at the equilibrium wage gets one; d. Unemployment is *voluntary*:
i. Unemployed are workers who think the equilibrium wage is too low, ii. Given the equilibrium wage, they prefer not to work.
But for the two decades considered, unemployment was continuously high and persistent: it is thus difficult to reconcile with the concept of voluntary unemployment. A possible explanation as for why unemployed workers could have voluntarily decided to earn nothing for so many years was given by Benjamin and Kochin (1979): unemployment benefits.
The U.K. had generous unemployment benefits. The Unemployment Insurance Act (1920) covered 11 million workers providing for them with the dole (weekly cash unemployment benefits) system of payments. Consequently, the 'Voluntary Army' begun: a set of workers who didn't have to take low paying jobs because they enjoyed generous benefits while being unemployed.
2) Keynesian view. In 1925, UK returned to gold at the pre war parity. Keynes argued that pre war parity overvalued current Sterling by 10%, implying a 10% reduction of Sterling balances from exports and an increase of 10% in the dollar value of domestic production costs.

1. Wages were already high compared to Europe and thus staple industries could not compete as imports became cheaper;
2. To restore the Balance of Payments, the Bank kept interest rates 1% higher in London than in New York, creating a reduction in domestic credit;
3. Wages could not adjust enough to fall in aggregate demand ('Sticky wages', downward wage adjustment is difficult): employment fell and unemployment increased.

ADD ON: THE MONETARIST VIEW OF THE GREAT DEFLATION
The monetarist theory implies that large variations of money stock have large consequences on prices and output. Subsequently, the "Friedman's rule" should be applied: central banks should target a (small) constant growth of the money supply.

But Fed deviated from Friedman's rule during the Depression: it tightened the money supply to avoid outflow of gold. Between 1929 and 1933 the U.S. money stock went down by 30% (the Great Contraction). There was a consequent sharp decline in prices and output, the Fed should have provided liquidity to counter the deflation.
A critique has been moved by Temin (1976), arguing that the decline in money stock was a consequence, not a cause, of the Depression. Fall in output implied decline in money demand and thus decline in money stock. Moreover, there was a weak financial system: banks did not fail because they were illiquid but because they were insolvent (bad loans, especially mortgages), hence providing liquidity to insolvent banks would not have helped.
Finally, in analysing the causes, the monetarist theorists were missing an international perspective; Eichengreen asserted that, to understand the Great Depression, an international perspective is required.

ADD ON: SOLUTIONS TO THE CRISIS

The first problem that was to be solved to exit the crisis, was the collapse of the Gold Standard: a new monetary policy was to be applied to eliminate the issues that the fixed exchange rate regime was creating (although of course it had its reasons to exist, such as eliminating the risk of exchange rate variation and promoting investors' confidence and capital flows).
That model, though, faces the 'trilemma' problem, i.e. the macroeconomic policy can include only two elements of the inconsistent trinity made by:

- Full capital mobility;
- Fixed exchange rate;
- Independent monetary policy.

The solution ultimately found was to restore independent monetary policies around the world, like U.K. and Sterling Bloc which abandoned gold in 1931. Then, states faced two possible alternatives:
1) Devaluation

1. Governments could *boost aggregate demand*,
2. Improved *competitiveness*,
3. Ability of central banks to act as '*lender of last resort*',
4. But this made it difficult for countries remaining on gold to *restore balance of payments equilibrium*;

2) Protectionism

5. *Increased* tariff rates (customs revenue/imports),
6. Restrictions on imports supplemented by *import quotas* and *exchange restrictions*,
7. Gold Bloc countries increased tariffs *more* than others, except for the U.K., which devalued and still increased protection,
8. Universal protectionism contributed to *decline in world trade*.

Arrighi (2002): The African Crisis

Political Economy of Africa, "new " and "old"

The idea that the primary responsibility for the African tragedy lies with African elites and governments has been common to most interpretations:

- Berg Report (1981), the assessment was highly internalist and critical of the African governments for having undermined the process of development by destroying agricultural production output and exports.
- "Markets and States in Tropical Africa" by R. Bates (1981), explains how state offcials in newly independent countries used the instruments of economic control inherited from colonial regimes to benefit urban elites undermining the process of development.

These internalist views where challenged by the African government in the Lagos Plan of Action (1981), which traced the sources of the crisis to a series f external shocks and saw resolution in fostering greater economic integration and cooperation. However after the Sahelian drought and famine of 1983-4, in 1985 the OAU produced the Africa's Priority Program for Economic Recovery which openly acknowledge the responsibilities of African governments for the crisis, and agreed to implement a variety of policies consistent with the berg report.

Arrighi and Saul's view pointed out a pattern of "surplus absorption" as the most central of these problems: the benefits for the elites were restraining the growth of agricultural productivity (.→ concept of perverse growth) and domestic markets and that a change of these patterns required an attack on the privileges of the elites. However they paid greater attention to the global context surrounding the development of the African countries, giving a key importance to world capitalism in shaping outcomes.

Uneven Development of the African Crisis

Although Africa Is by far the worst performer among Third World regions, this was almost entirely a post-1975 phenomenon. Furthermore a sharp bifurcation between Sub-Saharan Africa and the performance of East and South Asia happened after the 1975 date along with some Important reversal of tendencies within the first world Instead.

World Systemic context of the African Crisis

The global crisis of the 1970s was simultaneously a crisis of profitability and of legitimacy. Policies and ideologies that had played an essential role in launching and sustaining the worldwide expansion of trade and production in the 1950s and 1960s—so-called Keynesianism, broadly understood—became counterproductive. The initial response of the United States to the crisis—withdrawal from Vietnam and opening to China, but continued adherence to Keynesianism at home and abroad—only worsened it, provoking a precipitous decline of US power and prestige; Integral to this decline was a widespread disenchantment with the 'development project' launched under US hegemony. Initially the global crisis seemed to improve the economic prospects of Third World countries as the terms of trade—especially for oil-producing countries—improved. Third World countries sought to renegotiate the terms of their incorporation in the global political economy.
The United States, which in the 1950s and 1960s had been the major source of world liquidity and of direct investment, in the 1980s became the world's main debtor nation and by far the largest recipient of foreign capital. This was a reversal of historic proportions, likely to be the single most important determinant of the contemporaneous reversal in the economic fortunes of North America and of the bifurcation in the economic

fortunes of Third World regions → On the one hand, there were those that, had a strong advantage in competing for a share of the expanding North American demand for cheap industrial products → on the other hand there were regions that, for historical and geographical reasons, were particularly disadvantaged in competing for a share of the North American demand.

The African Crisis in Comparative Perspective

Why South Asia performed much better than Latin America and Sub-Saharan Africa was because through the 1970s, Latin America and Sub-Saharan Africa had become far more dependent on foreign capital than East or South Asia; As the re-direction of capital flows towards the United States gained momentum, such dependence became unsustainable.
Comparing Sub-Saharan Africa and South Asia on

- Labor

Arthur Lewis's classic argument that underdeveloped regions are characterized by 'unlimited supplies of labour' never really applied to Africa, where labour appears to have always been in short supply. The precolonial contact with Western countries though import of guns and the export of slaves—undoubtedly worsened whatever structural shortage of labour. Under colonialism the supply of labour did expand; but so did the demand for it. During and after de-colonization, the underlying shortage of labour was reproduced partly by a demand for Africa's natural resources which remained brisk, and partly by the efforts of the newly independent states to modernize and industrialize. Only *after* the collapse of the 1980s structural labour deficit turned into a labour surplus in spite of the collapse of urban 'internal labour markets'.
East Asia's structural abundance of labour relative to natural resources had multiple origins. In part, it was due to the material culture of rice cultivation. In part, it was a consequence of the China-centred 'population explosion' which followed the intensification of commercial ties with the Western world in the sixteenth and seventeenth centuries. It was only in the 1980s—when these efforts in the capital- and natural resource-intensive techniques became both more labour-intensive and more successful.

- Entrepreneurship

Fortunately for East Asia, and unfortunately for Sub-Saharan Africa, the discrepancy between local entrepreneurial resources inherited from the colonial and pre-colonial past was also far more favorable to East Asia. The latter was in fact by far the oldest and most extensive among the region's entrepreneurial networks.
Nothing of the sort could be observed in Sub-Saharan Africa.

- State- and national-economy formation.

These competitive advantages of East Asia and disadvantages of Sub-Saharan Africa were compounded by the very different legacies each inherited in the domains of state-formation and national-economic integration. throughout the eighteenth-century East Asia was ahead of any other region of the world, Europe included, in both respects. In sharp contrast to East Asia, Sub-Saharan Africa inherited from the pre-colonial and colonial eras a political-economic configuration that left little room for the construction of viable national economies or robust national states.

IN COLLABORATION WITH