WAR AND DEPRESSION

By

J. B. CONDLIFFE

CAN the world afford any more great wars? Is there any escape in neutrality? What is the safest policy for this country to follow?

In this concise, graphic survey, one of the world's best-informed economists traces present social and economic conditions back to their origins, and points out what changes national policies must undergo if the nations are to find their way back to prosperity.

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WORLD AFFAIRS PAMPHLETS

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BY mutual agreement, the World Affairs Pamphlets, formerly issued by the Foreign Policy Association and the World Peace Foundation jointly, begin with this number to be published by the World Peace Foundation alone.

The Foreign Policy Association will inaugurate a new series of publications to be called Foreign Policy Pamphlets, details concerning which may be obtained by writing to the Foreign Policy Association, 8 West 40th Street, New York City.

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The opinions expressed in this pamphlet are those of the author and do not in any way involve the responsibility of the World Peace Foundation.

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"The fathers have eaten sour grapes and the children's teeth are set on edge."

EZEKIEL, 18, ii.

WAR AND DEPRESSION

I

THE ULTIMATE COSTS OF WAR

For a great, and increasing, number of the present generation the war of 1914-1918 has already passed into history. Even for those who actually participated in it, memories grow dim, and the more horrible experiences are mercifully apt to fade. The legend of an heroic age begins to take shape, and the personal losses, hardships and privations are forgotten. By contrast with the sufferings of the present day, these distant troubles seem hardly worth recalling. In some quarters, indeed, the grotesque suggestion is made that another war is needed to drag the world out of the depression into which it has fallen, to restore morale and discipline and to create employment.

It is not the purpose of this pamphlet to dwell upon the horrors of war or to attempt the thankless task of convincing those who have never experienced its futility that it is in fact a dreary, dirty, nerve-wracking and utterly unromantic business, much more akin to ditch-digging than to chivalry. The ultimate costs of war, however, are more important than the immediate suffering involved. It is the reality of these ultimate costs that needs to be stressed at the present time—the direct connection that exists between the orgy of destruction twenty years ago and the present economic disorganization. We need to learn the vitally important truth that "the true lesson of this depression is that the world cannot afford any more great wars."[1]

To economic students this is a truism. Whatever the intervening secondary causes may have been, the ultimate cause of the great depression that has lasted since 1929 is to be found in the impoverishment and economic dislocation caused by the war

[1] Leonard P. Ayres, *The Economics of Recovery,* The Macmillan Company, New York, 1933.

which began in 1914. It is, of course, obvious that many complicating factors have intervened since the war ended. No one would contend that financial crises and economic depressions are solely consequences of war. But the economic history of the modern world affords abundant proof that the distortion of economic activity occasioned by a great war inevitably increases the severity and lengthens the distress of these periodic fluctuations of industry.

There have been three bad sequences of depression since the beginning of the nineteenth century, each following an important war. The three intervening periods of relative prosperity, and lighter, less prolonged, depression, have been the culminating years of long periods of comparative peace. The fact is that civilization is based upon cooperation, and prosperity upon peaceful trade and interchange.

After the Napoleonic Wars ended in 1815, there was a prolonged period of distress in both belligerent and neutral countries, punctuated by a series of violent financial crises. Despite the fact that the Industrial Revolution was in full swing, adding greatly to productive capacity, the inflation of currencies, destruction of trade, disorganization of industry and heavy debt burdens consequent upon the prolonged wars, created much the same sorts of problems as those with which we have become only too familiar in recent years. Unemployment and social distress were prevalent, there was much talk of over-production, and a succession of speculative booms was followed by spectacular collapses of security values. In 1819, 1825, 1836-1839 and 1844-1847, these paroxysms of industry were severe and prolonged. It was at the end of this period, incidentally, that Karl Marx formulated his prophecy that capitalism would destroy itself in such recurring wars and crises.

By contrast the crises of the ensuing years of prosperity were mild, until the dislocation of production and currency disorders provoked by the next series of conflicts, in the late 'sixties, once again plunged the world into severe depression. The Civil War in the United States and the triad of wars waged by Germany in this decade were succeeded by a hectic boom which broke into panic in 1874 and ushered in the long train of falling prices that lasted till 1895 and made the intervening cycles of depression longer and more intense. Scientific progress continued, new lands were brought into cultivation, communication was vastly improved and production rapidly increased; but the financial and economic aftermath of the wars caused further panics culminating in the great banking crisis of 1890. Even at this time, however, the inter-connections between important trading countries were not so close nor so instantaneous as they have since become, so that the actual dates of crisis varied somewhat from country to country, and there was not the same universality of depression as we have experienced in the last few years.

The turn of prices in 1895 was indicative of a new era of confidence and expanding prosperity. The "dead horse" of war losses had been worked off.[1] The natural tendency of the credit system is expansive; and industrial initiative, given stable currencies, reasonable trade freedom and relief from the crippling burdens of war indebtedness, has been able, in every period of peace, to enlarge production and raise living standards. The continuous increase of scientific knowledge places ever greater resources at our disposal, for our enrichment or our destruction. The application of new scientific methods to industry, however, requires the accumulation of capital. The specialization which makes possible the mobilization of the whole world's resources for our enjoyment requires international trade and cooperation. In times of peace both are possible; but the diversion of scientific research and organizing ability to destructive purposes dissipates accumu-

[1] The sailing ships on long voyages used to advance a month's pay to the seamen. At the end of the first month the crew would hoist a guy and cast off the "dead horse," as a sign that the payment received had been worked off, and wages were accruing again.

lated capital and wrecks the delicate machinery of cooperation and credit.

Wars do not normally occur at a time of financial exhaustion and economic depression. It is, indeed, an ironic commentary upon our civilization that the peoples of the Western world have in modern times resorted to violence only when, after a prolonged period of constructive economic cooperation, they have felt strong enough to do so. During the actual conflict there is an illusion of enhanced prosperity, but in reality actual impoverishment. Those industries catering to war demands, including in some countries agriculture, expand rapidly. A labor shortage arises because of the drain of man-power. Moreover, modern warfare is increasingly dependent on economic resources and organization, and every possible resource is pressed into immediate military service, often very wastefully. It is the increasing industrialization of modern warfare, indeed, that makes its ultimate effects so terrible and its outlawry so imperative. In war activities, as in industry, the machine age constantly demands more active participation by the whole community. The distinction between combatants and non-combatants becomes more difficult to draw and military offense is directed almost as much to destroying the civilian bases of supply as to crushing the opposing force. The development of war in the air is certain to intensify this tendency.

The abnormal demands upon industry for war purposes, therefore, create temporary profits and employment, and at the same time the stimulus of war psychology calls forth superhuman efforts. Privations are laughed at and hardships willingly endured. Abundant, but depreciating, money aids the illusion of prosperity. Gradually, however, the realities of impoverishment, wasted capital, diminished resources, lowered vitality and reduced living standards become apparent. No people can long continue to live upon its reserves of material and nervous energy.

Shortages of essential commodities, even foods, begin to appear, and the strains of longer hours and excessive effort begin to tell. These costs are heavier in some countries and among certain classes, and eventually the will of one or other of the belligerent peoples breaks and disintegration sets in. When the war ends, however, all the peoples—belligerents and neutrals, victors and vanquished—become involved in the ultimate costs inherent in the destruction of trade, the demoralization of moneys, the dissipation of reserves, and the accumulation of debts. There is no victor in a modern war, nor any real gain to the neutrals. All nations are involved in the collapse of their common economic welfare. Neutrality and isolation may avoid military casualties, but there can be no neutrality or isolation from the economic wreckage that is the inevitable aftermath of a great modern war.

II

DISORGANIZED PRODUCTION

In attempting to demonstrate the undoubted connection that exists between the war of 1914-1918 and the depression from which the world is now slowly recovering, there is a superficial temptation to trace everything back to the single cause under consideration. History is continuous. One event springs out of another, and the whole forms a chain of causation which in retrospect appears to have been inescapable. It is only too easy to become obsessed with one single aspect of such a vast problem, and to ignore or belittle everything that does not conform to one's main thesis.

Such exaggeration of emphasis is largely responsible for the attitude taken in recent times by many economic students who are impatient of the continuous alibi which the war has provided for those who wish to escape the responsibility for action with respect to current problems. Many who immediately afterwards were most emphatic concerning the evil consequences likely to flow from the war and the vindictive peace by which it was concluded, have moved with the times and focus their attention now upon measures which they deem necessary under present conditions.

The truth surely lies between these extremes. It is of little value to ascribe all our troubles to mistakes, however grave, committed in the past, especially when there is ample evidence to show that at various points in post-war history different decisions of policy might well have avoided many subsequent difficulties. But, at the same time, we should realize clearly that the political, economic, financial and psychological consequences of the war, presented those responsible for decisions of policy in the post-war world with a series of problems more difficult and urgent than any which might reasonably have been expected in peace time.

Moreover, the spirit of war was projected into the peace settlement and subsequent national policies.

As one obvious example, it is worth recalling that during the period of actual hostilities, despite the feverish stimulus to industry provoked by the emotional response to patriotic appeals and despite the encouragement to production provided by depreciating currencies, there were actually acute shortages of many essential commodities. There was little or no unemployment, the services of women were enlisted in new occupations, trade practices and labor regulations were suspended to allow new processes to be introduced so that great encouragement was given to mass production, older men did not retire and some came out of retirement. Especially in the belligerent countries, every resource was strained and all reserves were mobilized. And yet there were shortages, price disturbances and the necessity for rationing and for voluntary economy.

Every encouragement was given to efforts to make good these difficulties, and new production was called forth, sometimes by alternative methods and often by the stimulation of new areas of production. While incredible efforts were being put forth to blast to destruction the fields and factories in the battle area and the wider field open to aerial attack, scientists were studying ways of producing substitutes, distant producers were extending their cultivation or building new factories, and new shipyards were hastily being constructed to fill the gaps in world-shipping caused by submarine attacks.

After the war ended, the world was faced with a thoroughly disorganized productive system. To remedy the shortage of bread in Europe, the United States had vastly extended its wheat production and was once again exporting quantities comparable with those that had come from the newly opened Middle West in the 'seventies. Some of the land broken for cultivation is now blowing eastward in dust storms, while restored production in Europe, partly stimulated by heavy agricultural protection designed to build up reserves of foodstuffs once again, has for many years presented the world market with the problem of huge accumulated stocks and surplus production of this basic commodity. To shift labor and resources from farming to other forms of production was not an easy matter, particularly since international agreement was needed, or else a willingness to let prices take their downward plunge and eliminate the higher-cost producers. Since land values had risen under the stimulus of high prices, and farm finances were a problem in so many countries, no government was willing to see its producers sacrificed to the necessity of international adjustment.

In the same way chemists found ways of producing nitrogen from the air, and after the war the Chilean nitrate industry collapsed. In Great Britain, and also in neutral countries, and in the United States, Japan and even China, shipbuilding yards were greatly extended and production was rapidly approaching a peak when the war ended. Some hundreds of ships were built and never used. Many of them were bought later by Mr. Ford and transformed into automobiles, while others lie still moored in the Mississippi River near New Orleans. The troubles of world-shipping, aggravated by the later decline of world trade, date from the immense increase of the world's merchant marine in the year or two immediately following the war. Moreover, new shipbuilding yards had come into existence with greatly increased capacity, and this basic industry has been depressed ever since.

So the story goes on. A great fillip was given to industrial development in new countries, such as Japan and the British Dominions, which after the war competed directly with the restored production of Europe. The war industries in particular were faced not only with heavy accumulations of unwanted materials—great dumps not only of munitions but of such articles as motorcycles and railway materials, were a common sight in many countries when the war ended—but had transformed their equipment for war purposes. In almost every country there were so-called "reconstruction policies," but the difficulties of transition back to peace-time activities were colossal. Not least among them were the employment problems presented by the re-absorption into normal industry of millions of men who for months or years had been in the armies.

The view was often expressed that the stimulus to invention had made the world at least potentially richer, and it is, of course, true that many new activities such as flying, automobile production, and the machine industries generally (including the mechanization of farming) were greatly stimulated. It is worth noting, on the other hand, that progress in this respect was greatest in precisely those industries the over-stimulation of which is the normal sign of the unbalancing of production that leads to an industrial crisis.

The subsequent course of events cannot be traced in detail. There was a short but hectic post-war boom which collapsed in 1919. Again, after the worst of the wreckage had been cleared away and the terrible inflations in many European countries either had run their course to complete collapse or had been arrested, the re-equipment of the impoverished countries appeared to offer an outlet for the capital equipment that had accumulated in more fortunate lands. Credit on a large scale was necessary, however, and in the course of providing that credit another great boom developed, the aftermath of which is still with us.

The statistics of world industrial production tell an interesting story in these post-war years. The tendency was steadily upward for decades before the war and was not seriously interrupted even in years of so-called crisis and depression. The war interruptions were followed by an even steeper rise from 1925-

1929, but the subsequent collapse brought the level in 1932 down almost to that of 1913—and in the meantime twenty years of progress had been lost.

To many people the paradox of poverty and distress in the face of enormous productive capacity appears almost beyond explanation; but the problem is largely one of wrong capacity in the wrong places, aggravated by a breakdown of the distributive system. The normal trend in a world growing progressively richer is away from the more fundamental to the less essential industries. More efficient, mechanized agriculture called for fewer laborers, since, as Adam Smith long ago observed, "the capacity of the human stomach is limited." Indeed there were some signs of approaching saturation of the market in many countries for even elaborate industrial products such as automobiles, and the growing possibility that more time and resources might become steadily available for personal services and amenities. It is futile to grow more wheat than can be eaten or build more ships than can be profitably used.

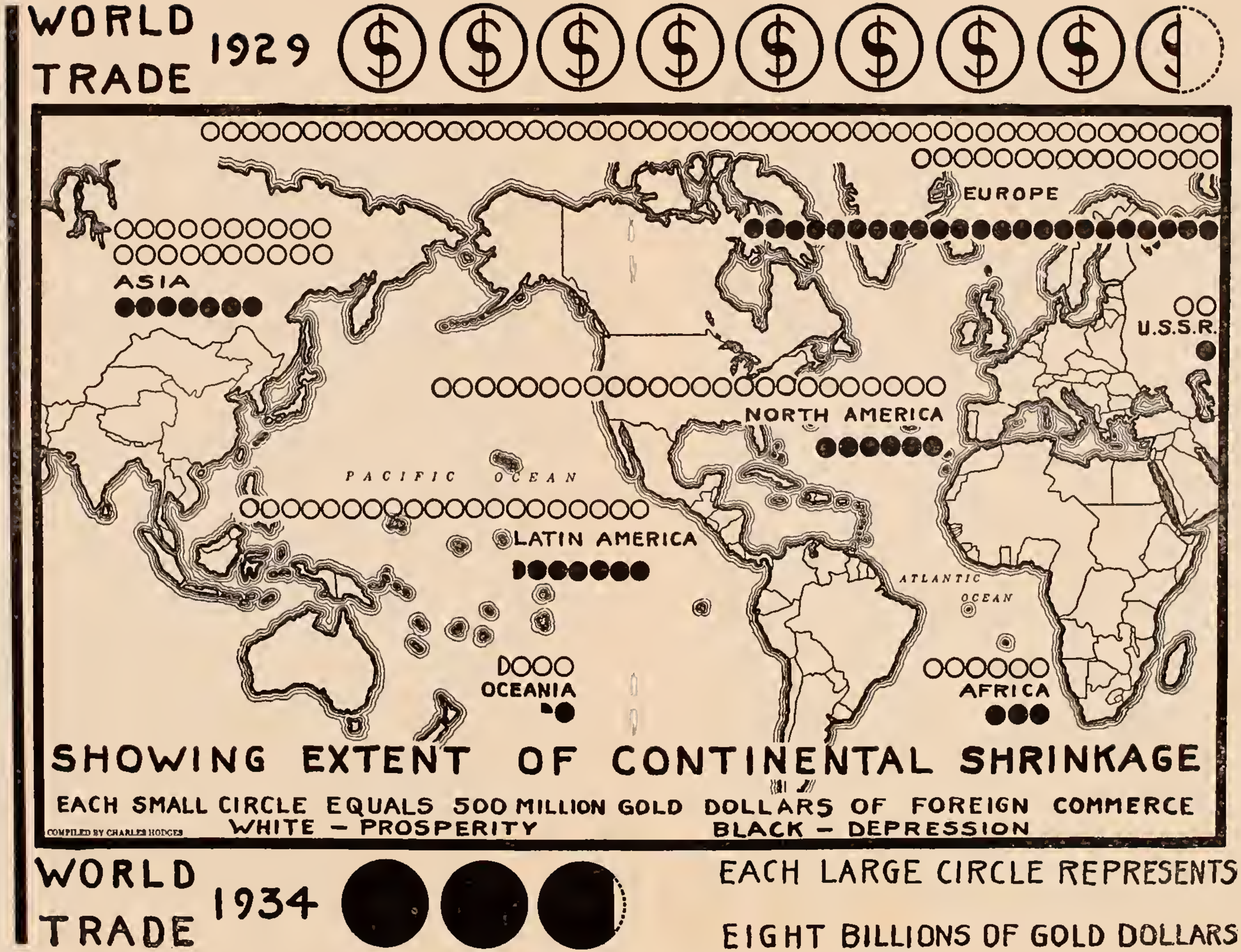
The disorganization of production in the post-war years has unfortunately put back the clock in this as in many other respects. It would be irony to pretend that there is too much food in a world where famines still occur or too great production while standards of living, even in advanced industrial countries, remain deplorably low; but before these deficiencies can be remedied the balance of production must be restored. Prices and costs must be gotten again into equilibrium and international trade and specialization resumed. Not only must the aftermath of the last war be cleared away but there must be reasonable assurance that the nations need not safeguard themselves by isolationist policies against the fear of being suddenly caught unprepared and unawares in a similar catastrophe.

III

THE BREAKDOWN OF CREDIT

Apart from the disturbance of real production, which is perhaps the least serious, and easiest to remedy, of the consequences of war, account must be taken of the damage done to the more sensitive elements of the body economic. The material cost of the war was very great, but it would have been easier to remedy if the credit and financial system had not been so seriously deranged—just as in a major surgical operation the damage to the tissues is often not so serious as the loss of blood and the nervous shock. There is little doubt that the material damage caused directly by the war is much less than that which has since ensued from the derangement of the world's economy. Even the loss of life was probably less than that subsequently caused by famine and impoverishment.

There are three main ways in which the financial conduct of the war caused great subsequent difficulty. The first arose directly from the inflation of currencies which occurred in greater or less degree in most of the belligerent, and some of the neutral, countries and from the rise in price-levels which was thereby induced in all countries. Destruction and consequent scarcity would in any case have caused rising prices; but it was easier for the governments that were faced with the pressing need for resources with which to conduct a great war, to obtain them by so manipulating the currencies as to cause a very sharp rise in prices. Instead of confiscating what they wanted, or taxing their citizens heavily enough to get command of these resources, they borrowed credit and, by increasing the supply of legal money, supplied the banking systems with the means of extending the bases of credit. With the proceeds of their loans they went into the markets and bought, the inevitable rise in prices taking resources out of reach of the purchasing power of their citizens,


WORLD TRADE 1929
EUROPE
ASIA
U.S.S.R.
NORTH AMERICA
PACIFIC OCEAN
LATIN AMERICA
ATLANTIC OCEAN
OCEANIA
AFRICA
SHOWING EXTENT OF CONTINENTAL SHRINKAGE
EACH SMALL CIRCLE EQUALS 500 MILLION GOLD DOLLARS OF FOREIGN COMMERCE
WHITE – PROSPERITY
BLACK – DEPRESSION
COMPILED BY CHARLES HODGES
WORLD TRADE 1934
EACH LARGE CIRCLE REPRESENTS
EIGHT BILLIONS OF GOLD DOLLARS

since most incomes lagged behind the rise in prices. Moreover, with rising prices, the first gains accrue to the organizers of industry so that there was a direct stimulus to increased production. The war was fought with present resources; but the payment for those resources was made by incurring obligations the subsequent redemption of which laid heavy debt and therefore tax burdens on the productive members of the community, thus causing an inequitable redistribution of income in succeeding generations.

An inevitable consequence of such a procedure is the distortion of the price-structure. The prices of those goods most necessary for war rose fast and stimulated unbalanced production. With rising prices and profits also, the capital value of farms and factories was written up and the re-capitalization of property resulted in heavy and fixed contractual obligations being imposed on productive enterprises. Thus land values rose sharply in cities and on the farms, share values increased and new enterprises stimulated by the apparent profits of the old, were constructed at higher costs. This again was fundamentally a redistribution of income made possible by credit inflation. No serious damage was done as long as prices remained high, but when they collapsed, as they always do eventually after such booms, the burden of costs remained for some time rigidly out of relation to the new price-levels.

This is, of course, a familiar phenomenon in all industrial cycles of boom and depression, but the currency disturbances occasioned by the war were of such magnitude that the amplitude of fluctuation was vastly greater than in pre-war depressions. The experience of previous post-war periods leads one to believe that the debt structure built up in such a way needs more than one paroxysm of depression, and a prolonged period of recuperation and increased production, before the property claims that have been created are cut down sufficiently to bear a workable relation to productive capacity. Private debts are reduced by various forms of bankruptcy and composition, public debts by default and conversions to lower interest rates. But the indebtedness left by the recent war was so colossal and the subsequent paroxysms so severe that their clearing up has deranged the industrial structure in such a way that the volume of production has fallen greatly. As in previous post-war periods, there are great possibilities of industrial and scientific advance, and eventually, no doubt, these will result in a volume of production which will make even the present huge debt burdens bearable, as the progress of the Industrial Revolution made what seemed the intolerable debts of the Napoleonic War period appear relatively insignificant a hundred or even fifty years later. But in the meantime the fall of prices and production has been so great that the debris is more than usually tangled and the process of clearing it away before rebuilding is more complicated.

The second blow which the financial and credit system received came from the unevenness with which different countries were affected by the currency disturbances following the war. In some, inflation ran its complete cycle, in others it was arrested at various stages, while in a few there was simply credit expansion, damaging enough in itself, but not sufficient to impair seriously the monetary bases of the credit system. The world as a whole emerged from the conflict with the international monetary system in ruins. Whereas before the war the different currencies, and therefore the price-systems, of the principal trading countries had for decades been kept in fixed relations with one another by the operation of the gold standard, these relations had been grossly distorted and continued to fluctuate. Specialized, and therefore efficient and low-cost, production was possible when there was a common monetary measure for the whole trading world. Merchants and producers could compare costs and prices internationally and could therefore maximize the world's wealth by buying the most efficient production and retailing it in the markets of greatest demand. Under these conditions the world's wealth grew amazingly. The resources of the most distant markets could be drawn upon to furnish every household with regular and certain supplies of a great variety of commodities in increasing bulk. The complexity of international trade continually increased and with it the world's wealth.

The conduct of trade with fluctuating currencies, however, resembles the nightmare imagined by Gilbert for billiard sharpers who are condemned to play

> "on a cloth untrue,
> with a twisted cue,
> and elliptical billiard balls."

It is perhaps difficult in a great free-trade area with a uniform currency, such as exists in the United States, to imagine what this means in an area cut up into such a number of independent national units as govern Europe. If the forty-eight separate states had independent currencies, fluctuating in relation to one another, and elaborate customs tariffs restricting inter-state trade, the United States would not be so rich through specialization as it actually is.

At the earliest possible moment an effort was made to restore the international monetary system. Great Britain returned to gold in 1925, and one after another the great trading countries re-attached their currencies and their price-systems to the international standard. But there was great difficulty in finding the appropriate levels at which to re-attach them. Some stabilized too high and others too low. Moreover, once the price-systems were inter-connected again, the strains caused by the divergent movements of their prices while they had been disconnected became operative. To face competition from international trade with countries whose prices and costs were out of equilibrium with their own, they had to re-adjust not only their prices but their productive organization which was governed by those prices. Moreover, the debts that had been incurred, and the reparation payments imposed, became realities when the international monetary system was restored. In the event, the difficulties of adjustment proved too great. A breakdown was averted for a few years by loans from the great creditor countries, particularly from the United States, but these could only postpone, and in the end aggravated, the collapse. When the credit expansion, which alone made the loans possible, got out of hand in the United States, the breakdown followed quickly, and the first effort to restore the international monetary system had failed.

One great element in this continuing international disequilibrium was the third factor referred to above as arising from the financing of the war. An enormous change had taken place in the debtor-creditor relations between the principal trading nations. One illustration alone will suffice to show the magnitude of this problem. In 1914 the investments of foreigners in the United States exceeded American investments abroad by about $3,000,000,000; but at the end of 1930 American long-term investments abroad exceeded foreigners' holdings in the United States by about $10,000,000,000, exclusive of war loans with an estimated value of well over $7,000,000,000. Even if a low rate of interest, say three per cent, is reckoned on these vast sums, a great change was demanded in the balance of international payments as between the United States and the debtor countries. For the interest obligations to be met in the only way in the long run possible—by the transfer of goods—there would need to have been a change in the balance of commodity trade, either by increased imports or by decreased exports, giving a net increase of imports into the United States worth about $600,000,000 a year. Prices would need to have fallen in the debtor countries and risen in the United States until increased production at low standards of living in the former and a considerable dislocation of established industries in the latter, had struck a new balance. From both sides the necessary changes were politically and socially so difficult as to be practically impossible. The debtor countries were already at low standards of living and most of them impoverished, while the United States had a surplus of agricultural exports, plus a surplus of manufactured exports, and was unwilling to relinquish either. For a time the "gap was bridged" by new American loans which balanced the annual payments due but increased the ultimate obligations. This obviously could not last, and has not lasted. Apart altogether, therefore, from the vexed problem of the political debts, the great change in the commercial obligations between citizens of the United States and other countries during the war and immediate post-war period has been one of the important contributing causes of the credit collapse.

It is perhaps well at this stage to repeat that at several important turning-points in the post-war period, wiser conduct of financial and economic policy might well have averted some of the worst of the disorganization which actually resulted. It is always easy to be wise after the event, and any critic can now see clearly some great errors that were made. It is to be remembered, however, that post-war political and economic statesmen were faced with problems of greater magnitude and difficulty than any likely to arise in normal circumstances. They had to act, and act quickly. Moreover, the background against which they had to act was one of inflamed nationalism—the best of all emotional mediums for vested interests to work in.

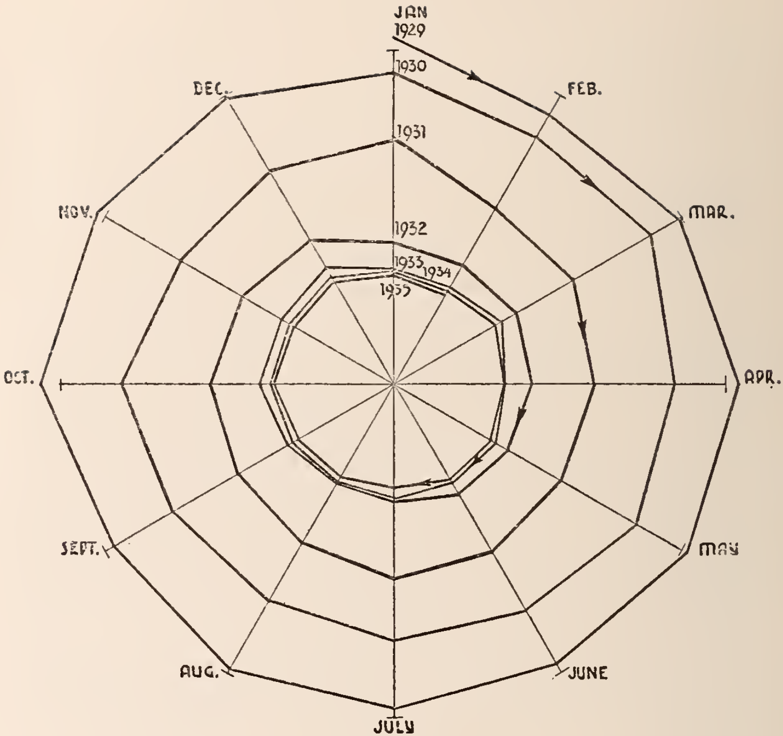
IV

VANISHING WORLD TRADE

One natural, but unfortunate, result of the collapse of credit and the breakdown of the international monetary standard, has been a great shrinkage in the volume, and still more in the value, of world trade. The figures, indeed, are startling if one can visualize the realities behind them. In 1934 the gold value of world trade was less than one-third, and the value even in depreciated dollars only about half, what it had been in 1929. Much of this decline in value was, of course, due to the sharp fall in prices; but, for the first time in recent history, the quantum of world trade also fell heavily. The actual quantities of the varied types of goods which enter into international trade are difficult to combine with any exactitude in a common measure, but the estimate made by the Economic Intelligence Service of the League of Nations is that the quantum of world trade has fallen in five years by over 25 per cent. As the diagram on page 24 shows, the decline of the trade figures has followed relentlessly month my month since the end of 1929.

There is, of course, action and reaction between the fall in trade values and the breakdown of credit. One of the conditions vitally necessary for the success of any real attempt to make the international adjustments demanded by the developments sketched in the preceding pages, was a greater relative freedom of trade, and especially a greater readiness on the part of creditor countries to receive larger imports in payment of the debts owed them. So far from this condition being fulfilled, there was every indication of tightening restrictions on trade. Great Britain became a protectionist country, and the United States passed the Hawley-Smoot tariff after prolonged debate which provoked reprisals even before the tariff became law.

The years since 1929 have resolved themselves into a veritable



CONTRACTION IN THE VALUE
OF WORLD TRADE IN TERMS OF GOLD
1929—1935

(Monthly average 1929 = 100)

race of economic armaments. Not only tariffs but a whole host of new and ingenious protective devices—quotas, prohibitions, licensing systems, milling and veterinary regulations, foreign exchange controls, clearing arrangements, bilateral treaties of an exclusive character—together with the increased difficulty of conducting trade with currencies continually fluctuating, have reduced world trade to a shadow of its former greatness. The trinity of complicated problems with which international economic relations is faced—exchange instability, excessive trade restrictions and frozen debts—acts and reacts on one another. Countries faced by competition from rivals with depreciated currencies, hastily erect new trade defences, and these in turn make further depreciation very likely if not inevitable. Moreover, it seems obvious that debt payments which were too heavy in 1929 are still less practicable in 1935 when the value of trade between the nations has fallen so heavily.

One further comment on the decline of world trade seems to be necessary. There is a school of thought which has always belittled the importance of international trade and viewed with favor attempts to restrict it in the interests of local industry. This view has recently gained a new argument from the belief now held by many people that the widespread development of industrial knowledge has largely removed the advantage derived from trade between highly industrialized countries and their sources of raw materials and foodstuffs. In many respects this is simply a new form of the old argument in favor of balanced industry within each national area; but it completely misses what most economists regard as perhaps the chief justification of international trade, the value of the very complex specialization that grows up between highly industrialized regions. Everyone admits that the bulk of the exchange of scarce materials and characteristic products for manufactures must go on; but the danger is that specialization may become narrowed to what is possible within national boundaries. It needs to be emphasized that the greatest trade used to be between such countries as England and Germany, both highly industrialized but supplementing and completing each other's equipment in ways that provided the consuming public with a rich variety and abundance of commodities from which to choose. If this sort of trade disappears, the world will be much poorer.

Moreover, many countries are organized upon the basis of continuing and even expanding world trade. Indeed, in every country large sections of industry, and heavy investments of capital, must be abandoned if international trade does not revive. Despite the utmost efforts of private individuals and governments, no country has yet, after five years of depression, succeeded in restoring the production or employment levels of 1929. It becomes more and more evident that "the hard core of unemployment" which is a problem in most countries, can be absorbed in only one of two ways. Either the export industries must be set going again, or wages must be reduced sufficiently to absorb the unemployed in industries catering to the local markets. The experts who prepared the agenda for the Monetary and Economic Conference in 1933 had no doubt of the consequences likely to follow if the present trend toward economic isolation persists. "Such a choice," they reported to the governments of the world, "would shake the whole system of international finance to its foundations, standards of living would be lowered and the social system as we know it could hardly survive. These developments, if they occur, will be the result, not of any inevitable natural law, but of the failure of human will and intelligence to devise the necessary guarantees of political and economic international order."

V

THE RATIONAL SOLUTION

It may, perhaps, be argued that the latest stages of the economic debacle, such as the decline in world trade, were caused by nationalist policies which need not necessarily have followed even a great war. The chaotic conditions of recent years, however, have been the combined result of the real problems of disorganization which the war left in its train, and of the decisions taken regarding them. It is possible that a peace settlement conceived in a conciliatory spirit and followed by cooperative international action to rebuild the stricken countries and restore economic activity by accepting such national adjustments as would facilitate international reconstruction, might have avoided the worst of the chaos which in fact we have experienced.

It is to be remembered, however, that the freest rein had been given for over four years to highly intensive nationalistic propaganda. How could it be expected that, after such a prolonged cultivation of hatred and destruction, the nations would take a sane and constructive attitude toward their mutual problems? The material costs of the war fade into insignificance beside this intangible, but very real, damage to the spiritual foundations upon which the wealth of the world has been built. Without mutual trust there can be no cooperation or credit, and cooperation and credit are the very bases of organized industry. Fear and insecurity have haunted the post-war world, and it is not reasonable to expect peace or prosperity to come easily in such circumstances.

Moreover, it should be realized that vested interests quickly grow up behind the shelter of abnormal conditions such as those of the war period, and such interests are quick to utilize the emotional appeal of national patriotism to buttress their own claims to public support. These interests are sometimes small, influential groups of powerful individuals, but often they are large, dispersed groups which can be politically important when organized. It is not necessary to subscribe to Dr. Johnson's impatient dictum that "patriotism is the last refuge of a scoundrel," to realize that those whose own definite interests are likely to be sacrificed in a policy of international cooperation which will, on balance, benefit the community as a whole, are easily able to persuade themselves and, in a time of emotional responsiveness, to persuade others, that their interest is the national interest.

Cool reason may point out that the main conflict of interest is not between one's fellow-nationals and the despised foreigner, but between different economic groups within one's own country. But it is only too easy in a time of emotional strain to forget logical realities and listen to such appeals as "making the foreigner pay," or "preserving the home market." Rational considerations are difficult enough to drive home in popular argument at any time, but it is asking too much to expect that they shall be listened to after the emotional stimulus of a great war.

Many of those who feel most keenly the futility and costliness of war are apt to feel that the only safe course for a country to pursue is a complete withdrawal from foreign entanglements. If there is any validity at all in the brief survey which has been attempted here, the conclusion is inescapable that there is no safety along that road. It is possible that determined neutrality might avoid military losses, but, short of a hermit policy of isolation such as Japan practiced for two and a half centuries, there can be no economic neutrality and there is no way in which a nation, by refusing to fight, can escape being drawn into the financial crises which follow war.

Nor is there any possibility of any country's avoiding the consequences of the economic war that follows the stimulated nationalisms of military propaganda. The world has been living in a belligerent economic atmosphere ever since "peace broke out" in 1918. This fact was pointed out forcibly by the chairman of the Cunard Steamship Company at the annual meeting of shareholders at Liverpool on April 24, 1935, when he said, "There is a war today—a universal war—and the weapons are not navies, armies or aeroplanes, but tariffs, quotas and shifted currencies." Sir Percy Bates went on very significantly to state that no one, not even the auditors, could say whether the balance sheet was sound. Shipping, the essentially international industry, does not know where it stands in the face of competing nationalisms, and in this respect it is typical of the whole structure of international trade, credit and communication. But what will happen to national industries—coal and steel, for example—or to employment, if these great international services are launched into bankruptcy by the confusions and hesitations of timid and narrow national policies?

The only safe policy for any country to follow is the positive policy of international cooperation in an effort to build up stable economic and political conditions once again. This is not an easy task, but the alternative of national isolation in a world which constantly shrinks as communications are improved and the credit connections between national economies become more complex and sensitive, is about as practicable as the abandonment of surburban residences for walled Chinese courtyards would be as a preventive of kidnapping. Ultimately we must build an international system or give way to more intelligent peoples who can. The sooner we stabilize our currencies, make rational trading arrangements and settle our debt problems reasonably, the sooner the world will resume its normal trend toward increasing production and rising prosperity.

No nation, however rich within its own borders, can insulate itself from international fluctuations unless it is prepared to abandon all contact with the outside world. Indeed, the richer a nation, the more it suffers when an international financial crisis shakes down its elaborate credit system. The old Chinese proverb that "he who sleeps on the floor never falls out of bed" holds true in economics. The nation that wants to make sure that no outside disturbance will shake it out of its bed, must be content to sleep on the floor as regards living standards. The only way to combine prosperity with reasonable security is for the nations to join in the sensible method of building up collective security and cooperative prosperity.