World War I, Recovery, and Collapse

<u>Lecture Outline</u>

- Origins of World War I (WWI)
  - Proximate causes
  - Deeper causes
- Costs of WWI
  - Human
  - Economic
- Consequences of WWI
  - International Political
  - International Economic (US the dominant economy)
- Global economic problems in the wake of WWI
  - European Reconstruction
  - War-Debts and Reparations Tangle
  - Why did the US refuse to provide international leadership?

Origins of World War I

- Proximate causes
  - Minor assassination in the Balkans
  - German mobilization for war ⇒ war
- Deeper (international) causes:
  - Relative decline of Great Britain
    - Economic and military decline signals end of Pax Britannica
  - Military competition
    - Arms races between European powers and US (Figure 1)
  - Race for colonies in Africa and Asia
    - Both a cause and a symptom of tensions
- The Aftermath
  - Human costs (figure 2)
  - New borders (figure 3)

Global Economic Problems after WWI

- **Need for European economic reconstruction**
  - All belligerents (except U.S.) devastated by the war
  - Hyperinflation in Central and Eastern Europe…and most of all in Germany, 1922-23
- **International monetary instability**
  - all nations (except U.S.) off the gold standard (Figure 4)
- **War debts and reparations tangle**
  - All belligerents (except the U.S.) in deep debt (Figure 5)
  - Allies owe U.S. $10.35 billion (Liberty Loans)
  - Germany required to pay $33 billion in damages to victors following Treaty of Versailles (Figure 6)
  - U.S. govt refuses to acknowledge the link been debts and reparations
- **Trade protectionism**
  - All nations raise trade barriers during the war (Figures 7 and 8)
  - U.S. is the biggest offender of the liberal creed

U.S. balks at international economic leadership

- **Internationally "stabilizing" U.S. policies**
  - Federal Reserve Bank of New York and private bankers (e.g. J.P. Morgan) help stabilize exchange rates and restore gold standards in Europe in the 1920s
  - Federal Reserve and private bankers work to resolve war debts and reparations problem (e.g. <u>Dawes Plan of 1924)</u>
  - U.S. private capital outflows finance world recovery and growth…until 1929
- **Internationally "Destabilizing" U.S. policies**
  - refusal to join League of Nations
  - refusal to forgive war debts
  - protectionist trade policies (Fordney-McCumber Tariff of 1922; Smoot-Hawley Tariff of 1930)

Figure 1: Pre-War Arms Race

Warship Tonnage, 1880-1910

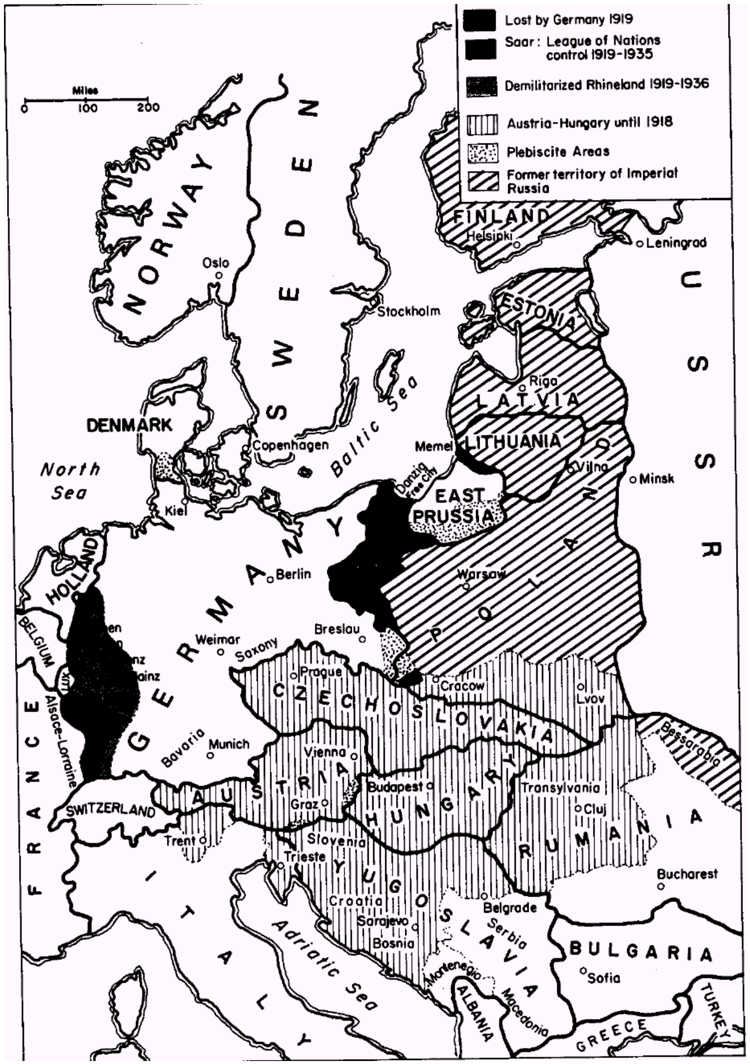
	1880	*1910*	*% change*
Great Britain	650,000	2,174,000	+ 235
Germany	88,000	964,000	+ 995
Russia	200,000	401,000	+ 100
United States	169,000	824,000	+ 388
Japan	15,000	271,000	+ 1,706

Figure 2: Human Costs – War Deaths

Country	Dead:	Wounded:
United States	115,000	206,000
Germany	1,808,000	4,247,000
Russia	1,700,000	4,950,000
France	1,385,000	3,044,000
Austro-Hungary	1,200,000	3,620,000
Great Britain	947,000	2,122,000
Italy	460,000	947,000
Turkey	325,000	400,000

- Total killed: 10 million. Total maimed: 21 million. To give perspective, <u>half</u> of all military-aged men in France were killed.
- Does not include the causalities of the Russian Civil War that erupted in 1917.
- Civilian causalities were relatively light: less than 10% of military causalities.
- Among the major belligerents, the U.S. suffered far less loss of life and limb

Figure 3: European frontiers after Versailles



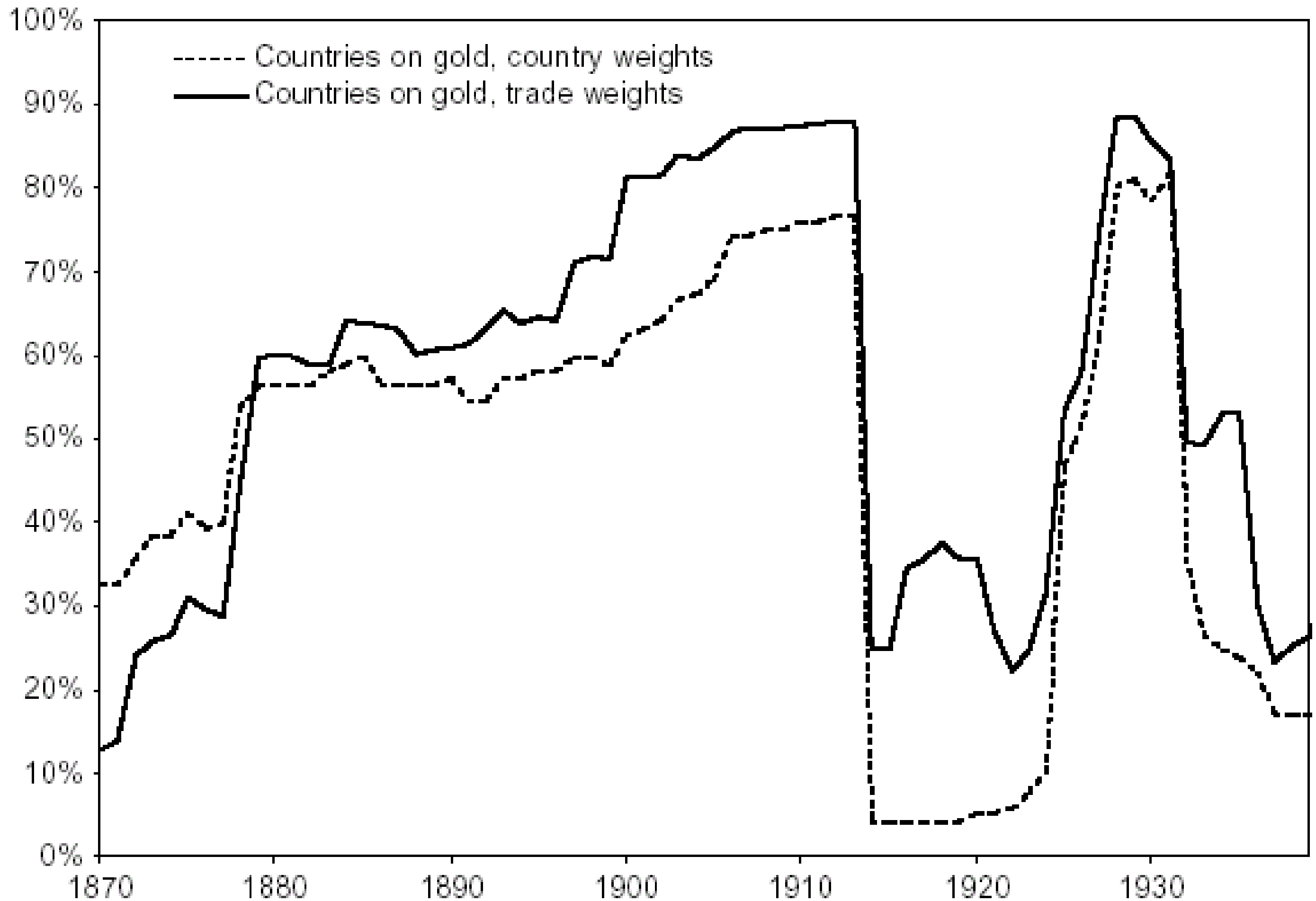
•<u>Germany:</u> lost 13% of its territory and 10% of its population. Also lost ¾ of its iron ore, and ¼ of its coal resources.

•Newly independent states were carved out of the empires of <u>Austria-Hungary</u> (Austria, Czechoslovakia, Hungary, Yugoslavia , Rumania, Poland), and <u>Russia</u> (Poland, Lithuania, Latvia, Estonia, Finland). The <u>Ottoman Empire</u> lost almost all its territory.

•These new "successor states" ran large budget deficits, which they financed by printing money – <u>hyperinflation</u> was the result.

•<u>Hyperinflation in Germany:</u> By the end of 1923, German prices were 1.3 **trillion** times higher than 1914.

Figure 4: Breakdown of the Gold Standard



Source: Antoni Estevadeordal, Brian Frant, and Alan M. Taylor, "The Rise and Fall of World Trade, 1870–1939." NBER Working Paper 9318, November 2002.

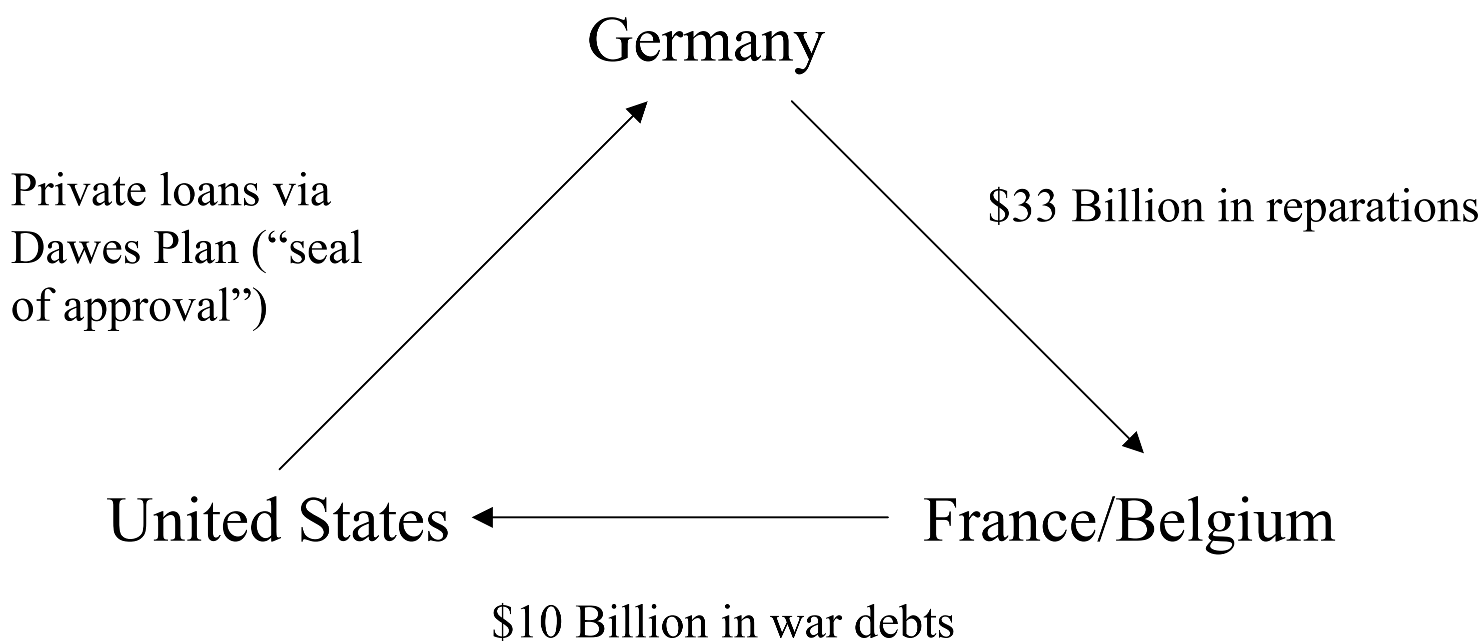
Figure 5: Allied War Debts Owed to the U.S.

European War Debts to U.S

Great Britain	4,277 million
France	3,405 million
Italy	1,648 million
Belgium	379 million
Poland	159 million
Russia	192 million
Czecho-	92 million
Rumania	38 million
Yugoslavia	51 million
Greece	27 million
Austria	24 million
Estonia	14 million
Armenia	11 million
Finland	8 million
Latvia	4 million
Lithuania	5 million
Hungary	1.5 million

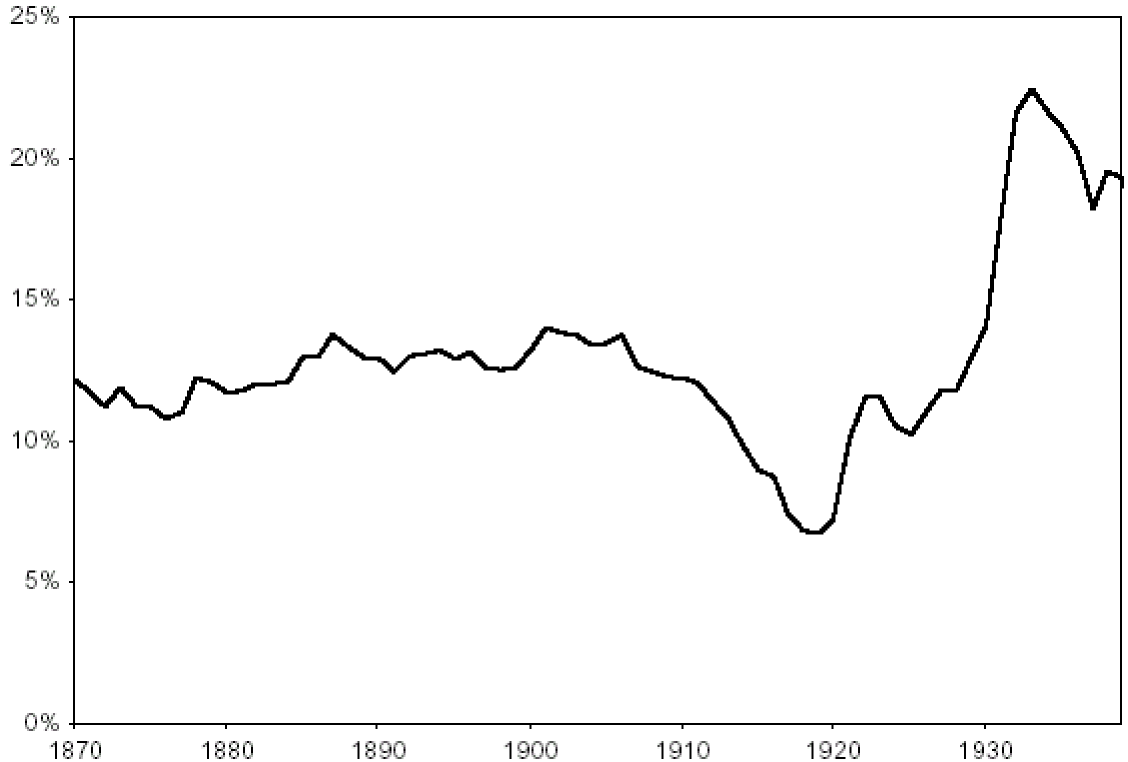
- European nations borrowed heavily from the U.S. to finance the war effort.
- U.S. govt lent a total of $10.35 billion via the “liberty loan” program between 1917-19.
- After the war, the U.S. govt refused to reduce or forgive these debts, a decision that posed major problems and helped pave the way for the depression…and WWII.

Figure 6: War Debts and Reparations Tangle



Private U.S. loans were an effective - but precarious - solution to the war debts/reparations tangle. If anything disrupted the flow of private capital to Germany, the whole transfer system would collapse. It did in 1929.

Figure 7: World Average Tariff Level, 1870-1939



Note and Source: For a sample of 35 countries. Antoni Estevadeordal, Brian Frant, and Alan M. Taylor, "The Rise and Fall of World Trade, 1870–1939." NBER Working Paper 9318, November 2002.

Figure 8: MFN gives way to trade blocs

Table 3. Trade with 'economic blocs' as percentage of total country's trade

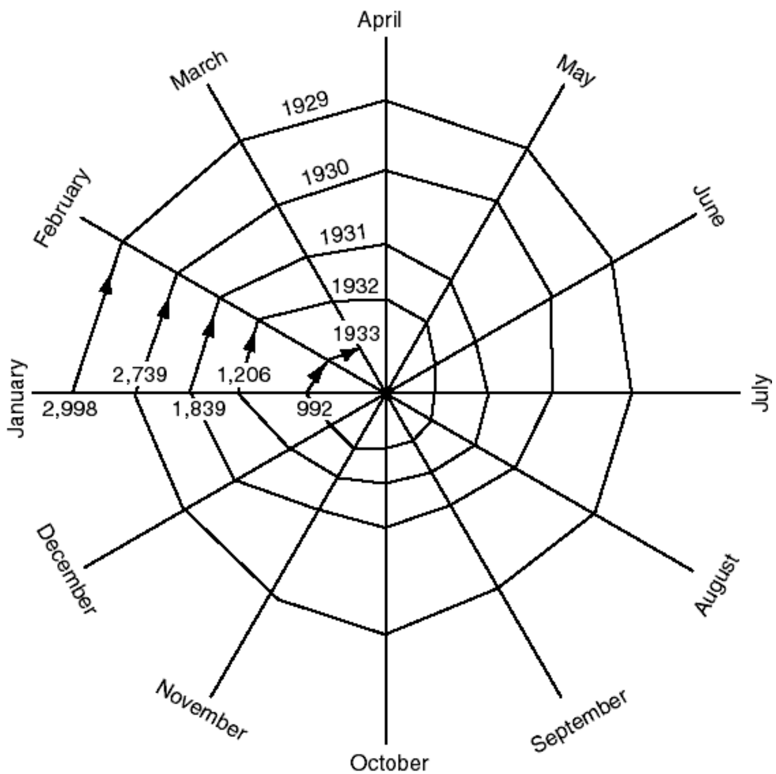
	Economic bloc	Imports		Exports	
		1920	1938	1920	1938
United Kingdom	Commonwealth, colonies, protectorates	30	42	44	50
France	French colonies, protectorates and mandated territories	12	13	7	12
Netherlands	Dutch colonies	5.5	9	9	11
Italy	Italian colonies and Ethiopia	0.5	2	2	23
Japan	Korea, Formosa, Kwantung, Manchukuo	20	41	24	55
Germany	South-East Europe, Latin America	16.5	28	13	24.5

Source: League of Nations (1939, p.186).

Source: Branko Milanovic, "Income Convergence during the Disintegration of the World Economy, 1919-39." November 2002.

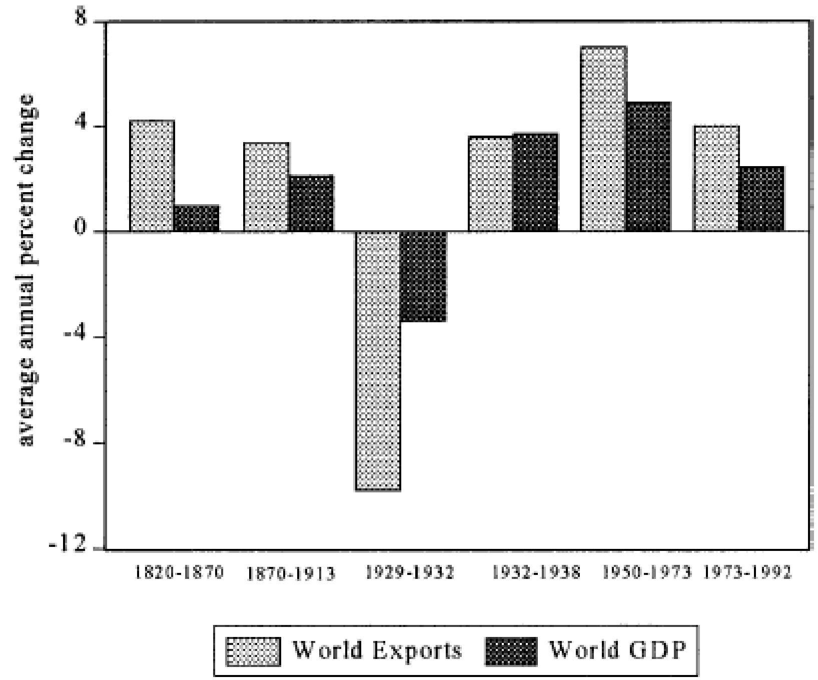
Figure 9: Collapse of World Trade, 1929-1933

THE KINDLEBERGER SPIRAL



Source: Charles Kindleberger, *The World In Depression*. Illustrates the implosion of world trade, 1929-1933, as countries (including the US) pursued the "beggar-thy-neighbor" policies of protection and competitive currency devaluation.

Figure 1. World export volume and world real GDP



Source: Maddison (1995).

Source: Douglas A. Irwin, "Long-run trends in world trade and income," *World Trade Review* (2002), 1: 1, 89–100.