Metroboom

Lessons from Britain's recovery in the 1930s

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SUMMARY

- The consensus view of the 1930s as a universally destitute place is a myth. While the mood was depressing in 1931, by the middle of the decade, recovery had come and a British boom was underway. There are important lessons for our own time as to how and why this was achieved.

- This is not to underestimate the pockets of severe poverty in the "Special Areas", so powerfully described by George Orwell in *The Road to Wigan Pier.* But after the financial crisis of 1931, healthy economic growth averaged 4% a year in real terms between 1934 and 1939, stimulated primarily not by rearmament but by the successful tax and economic policies of the National Government.

- The mid-1930s was a time of vibrant innovation and industrial growth. Housebuilding, car manufacturing, aircraft production and textiles all boomed while unemployment fell by almost a half between 1932 and 1937.

- This healthy recovery in the 1930s is in sharp contrast to the UK in 2012. Today, four years after our financial crisis, the economy remains frail, growth sporadic while unemployment is still rising.

- Five lessons can be drawn from the economic policies pursued first by Labour's Philip Snowden and later by Neville Chamberlain:

– Spending cuts work. Tough spending cuts – including an immediate 10% cut in benefits and civil service salaries – quickly led to balanced budgets and maintained the confidence of citizens, businesses and international investors. Today's cuts are much shallower in comparison.

– Austerity in the public finances must be matched by a cheap money policy to encourage the private sector to expand. While this was achieved in the 1930s, the appropriateness of today's Quantitative Easing policy is far less certain.

– Confidence in the legal and political foundations of the financial system must be restored. The early 1930s saw a number of high profile trials of those who had misbehaved in the previous decade. Today, nothing similar has happened and public confidence in the banks remains low.

– Tax cuts work. From 1934 on, Neville Chamberlain's tax cuts for families and the low paid gave a further boost to business confidence. The top rate of tax was only 37.5%. A similar approach is needed today.

– Press on with welfare reform. The National Government failed to do enough for the long-term unemployed and for those areas which had been hit particularly hard by the recession. Today's Coalition must not make the same mistake.

- Finally, while everyone has to make sacrifices, we should do so confident in the knowledge that, in Chamberlain's phrase, the quicker we can put down *Bleak House,* the sooner we can embark on *Great Expectations*.

1. INTRODUCTION

"*When politicians shrug their shoulders in the face of other people's despair, they are not just abdicating responsibility, they are making clear choices. That is as true now as it was in the Great Depression during the 1930s."*
Ed Miliband MP, New Year message, 2012.

"[In the 1930s] The promised private sector recovery failed to materialise as companies themselves sought to retrench. Unemployment soared. The Great Depression soured world politics and divided societies."
Ed Balls MP in *The Guardian*, 19 July 2010.

Myths about the 1930s abound and not just among Labour politicians. Ed Miliband and Ed Balls join many historians, filmmakers, and novelists in wrongly painting Thirties Britain as a universally hopeless, destitute place, rendered poor and miserable by a heartless, Conservative-dominated National Government. Framing the period with the Wall Street Crash at the beginning and the Second World War at the end, they portray it as a decade in which British decline gathered an irreversible pace. Flimsy economic growth, we are told, only returned when rearmament commenced towards the end.

Robert Skidelsky put this critique most eloquently when he wrote that the failure to cure unemployment at the time:

> "…had one important wider consequence: it helped create and confirm a mood of national self-doubt, of pessimism regarding the future, in which appeasement could flourish. The refusal to stand up to the dictators was part of the refusal to stand up to unemployment; and the mood of resignation, of fatalism almost, which supported it was the same in one case as the other."

But this commonplace view of the gloomy 1930s is at best partial and at worst a travesty, which falls apart in the face of the accumulated evidence. The mood was depressing indeed in 1931, but the economic data is decisive: by the middle of the decade, recovery had come and in much of the country an unrivalled boom was underway. The Special Areas which relied on shipbuilding and coalmining did have to wait for a boost to demand from rearmament, but for the rest of the country, the potential coming of war was nothing to celebrate.

The recovery came faster than it has today. It is four years since Britain tumbled into recession in 2008. By this stage in the 1930s, four years after the crisis first hit, a strong recovery was underway thanks to the bold and decisive action by policy makers at the time. Taxes were even coming down. But in 2012, economic growth is still crawling along and the deficit wide enough to concern the credit rating agencies.

The misrepresentation of the 1930s is therefore no longer an obscure historical point, but is of major current significance. It is a decade which has many lessons for our own time. Then, as now, there was a dangerous financial crisis which began in the

United States and which was followed by a “double-dip” in Europe. Unemployment and the consequent deprivation were rife in parts of the country. But the British economy as a whole actually recovered better and faster than any other major world economy except Germany and in 1935 expanded at nearly 7%. Industrial production regained its peak in 1934. The shops were soon full of exciting new consumer goods, such as radios, electric lights, cookers and irons. Family life thrived and new homes and new industries, such as man-made fibres, aircraft and car production, sprang up across the land.

This dramatic recovery was in no small part due to the tough decisions taken by British politicians of all parties. They successfully pursued very different policies to the Keynesian spending of Franklin Roosevelt’s New Deal in the US.

In summary, the experience of the 1930s raises two urgent questions:

- how did Britain lead the world in recovering last time it suffered a major financial crisis?
- and what lessons can we learn now?

2. THE “BANKERS RAMP” AND THE TWO BUDGETS OF 1931

The first big decision taken was to impose a fierce austerity and to balance the Budget. This iron, unyielding policy was hastily improvised during 1931 in the face of a second financial crisis which began in Europe and which, if anything, was worse than the 1929 crash in the US. Arnold Toynbee wrote that 1931 was an *annus terribilis*. For the first time, he said: “Men and women all over the world were seriously contemplating and frankly discussing the possibility that the Western system of society might break down and cease to work.”

By the beginning of the year, Britain was in recession, exports had collapsed along with world trade, industrial production was 17% below its peak, unemployment was climbing towards 2.7 million, or a record 22% of the workforce, and the country was governed by a minority Labour Government, led by Ramsay Macdonald. For more than 80 years, Macdonald has been seen as a pariah, but as we grapple with our own, similar issues, he appears more like a man who sacrificed his own personal popularity and political friendships for the good of the country.

Despite the dreadful economic backdrop, the Labour Government initially made several big errors, including significantly expanding the eligibility for unemployment payments to include those not genuinely seeking work. The Chancellor was Philip Snowden. In his first 1931 Budget he was forced to admit a widening deficit in the public finances and to raise income tax by 6d, or the modern equivalent of 2.5p to 25%. However, he was already preparing for deeper cuts in public spending and commissioned Sir George May, the ex-company secretary of the Prudential and one of the most respected men in the City, to write a report examining the evidence and to provide the intellectual justification for further austerity. The publication of the May report that summer was to prove a huge political and economic event.

One disastrous issue was solved almost by accident and contrary to the policies of all the major political parties. Britain was still on the Gold Standard at the pre-war rate of $4.86, as it had been since 1926. Nobody can be sure what the right rate should have been, but in retrospect one thing is certain: sterling was being held artificially high. This was an issue not dissimilar to the European Exchange Rate Mechanism fiasco of the early 1990s, when sterling was pegged to the Deutschmark at too high a level. The consequence was that British industry, which was anyway suffering from under-investment and poor labour relations, could not compete on world markets. Meanwhile, the Bank of England had an almost daily battle to ensure there was enough gold in London to honour its commitments.

In May 1931, the Austrian holding company for the Rothschild interests in Europe, Kreditanstalt, collapsed. The suspicion at the time was that this calamity was in part due to machinations by the French, who were keen to stop an Austro-German customs union and who consequently denied Kreditanstalt access to the Parisian capital markets at a critical moment.

London was the world's premier financial centre and British depositors, investors and merchant banks were heavily exposed to a serious disruption in Europe. Other international investors, for their part, started to lose confidence in London and its ability stay on the Gold Standard. On 15 July, Montagu Norman, Governor of the Bank of England, received a cable from his New York counterpart asking why the pound had suddenly dropped on foreign exchanges. It was clear that a massive run had begun on sterling; and gold effectively started to flow out of the Bank of England in an unstoppable torrent.

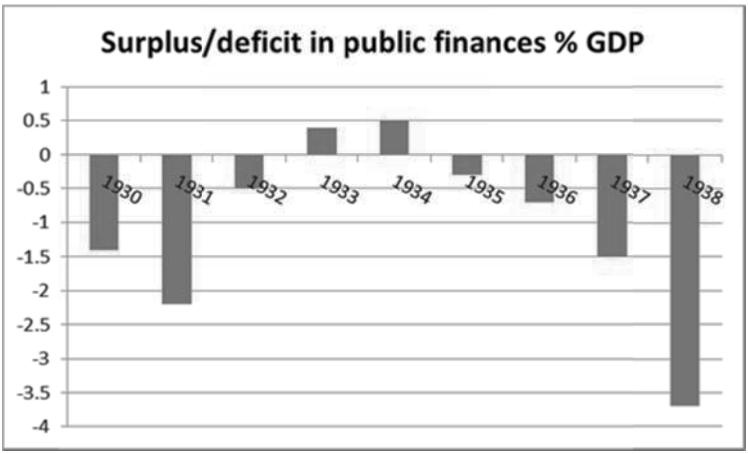
Two major reports were then published by the Government. The first was the Macmillan Report into the City's relationship with industry, which contained a paragraph suggesting that London markets had a very large short-term funding deficit. The second was the May report – mentioned above – which appeared at the end of the month and disclosed that the prospective deficit in the public finances was much worse than thought at £120 million, and consequently called for an immediate 10% reduction in government expenditure.

Much has been written about the frantic negotiations held in London in August 1931. But the main point is this. In order to stay on the Gold Standard, the Bank of England needed an emergency loan from New York which its agents, JP Morgan & Co, were negotiating. But this loan was dependent on closing the deficit in the public finances, specifically by implementing the May Report. This was the so-called "Bankers' Ramp", as Cabinet discussions on savage public expenditure cuts were constantly interrupted by cables from New York on what would or would not be acceptable to bankers on Wall Street.

The Conservative opposition, steered for the most part by its Treasury spokesman Neville Chamberlain, was also involved as its support was necessary to get any legislation through Parliament. When it became clear that most of the Labour Cabinet would not support the draconian cuts, Macdonald resigned only to be reappointed within 24 hours by George V at the head of a coalition of all three main parties. The bulk of the Labour Party refused to co-operate, however, and expelled Macdonald and his allies.

Philip Snowden stayed on as Chancellor and brought in a drastic second Budget in September which included an immediate 10% cut in all unemployment benefits and all civil servant salaries.

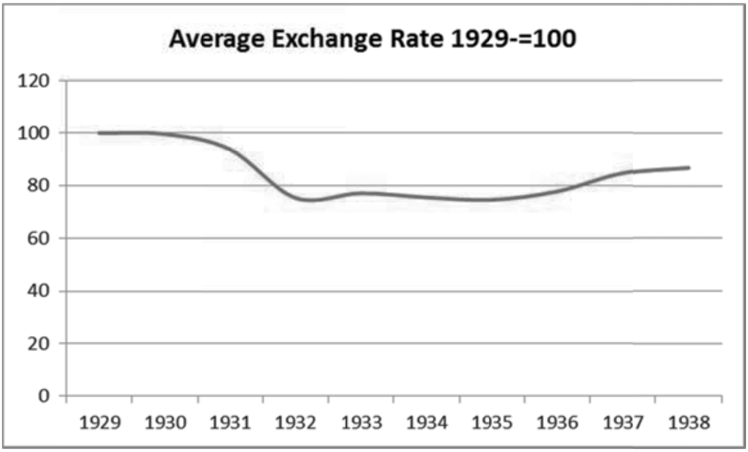
In retrospect, the talks to put together the 1931 coalition had much to recommend them. First, because of the May report, everybody knew what had to be done. Second, the situation in the markets was so serious as to concentrate minds. And third, George V (also a neglected figure) was an important influence and source of common sense. There was a very narrow agenda: to balance the budget.



Chamberlain only ran a surplus in two years of his tenure at the Treasury, but his efforts and those of his predecessor Snowden left the deficit much smaller than it is currently. Even in 2012, the Treasury is forecasting a deficit of 8% of GDP.

The cuts of autumn 1931, which were far more immediately fierce than anything put through by the Coalition today. They were felt particularly harshly by ratings in the Royal Navy, some of whom were told they would receive pay cuts of 25%. A few days after the Budget, the North Atlantic Fleet anchored at Invergordon refused to muster. To see this mighty Navy, which had dominated the seas and defended the Empire for more than a century, reduced to such a humiliating condition, was a symbolic development and the final blow as far as international investors were concerned.

Needless to say, bungling by the Admiralty in Whitehall made things worse, as it failed to give clear and timely instructions. The mutiny was a front page story around the world. Ministers were forced to take Britain "temporarily" off the gold standard. The pound was devalued by some 30%, falling to $3.40 by Christmas, which subsequently proved to be a huge blessing. Contrary to expectations, the panic in the markets was short-lived. A few days later, a general election was called for October, which resulted in huge gains by the Conservatives. As for the naval ratings, they were told none would face pay cuts of more than 10% and 24 of the ringleaders were discharged. This was relatively lenient treatment for an offence which notionally carried the death penalty and was perhaps recognition that their cause was not unjustified.



Source: Crafts

By the end of 1931, therefore, two massive policy decisions had been taken: to cut public spending immediately by 10% and to devalue. A year previously, no major party had wanted to do either of those things, but by the autumn of 1931 there was a weighty political consensus and a vast majority in Parliament behind these measures. Only a handful of Labour MPs disagreed that these were necessary steps to be adopted not due to ideology, but as a pragmatic response to the very difficult circumstances of the time.

3. CHAMBERLAIN'S RECORD AS CHANCELLOR

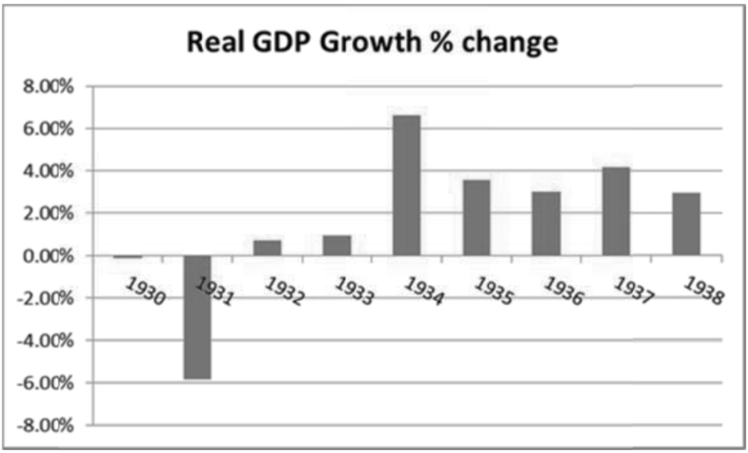
There are few more maligned Conservative politicians than Neville Chamberlain, the architect of appeasement of the Nazis. That ultimately proved to be a bad policy, badly executed. But Chamberlain only took his attempt to play for time with Hitler too far in the final two years of his life, during his brief and disappointing Premiership. By this time he was 68 years old.

The previous 30 years were characterized by worthy public service, first in Birmingham, where he was mayor and then in Westminster. By the middle of the 1930s, this Midlands businessmen, who had spent his early life working in the family screw-making business and trying to run a sisal plantation in the Bahamas, dominated the British political scene at home and abroad. Time Magazine described him as "Britain's Strong Man" and put him on the front cover in 1933. He was their runner-up Man of the Year in 1932 before winning in 1938.

Chamberlain was a brilliant, principled Chancellor. He formally took over from Snowden after the General Election of October 1931, but he had been influencing economic policy from the moment Macdonald's Government got into trouble in the summer.

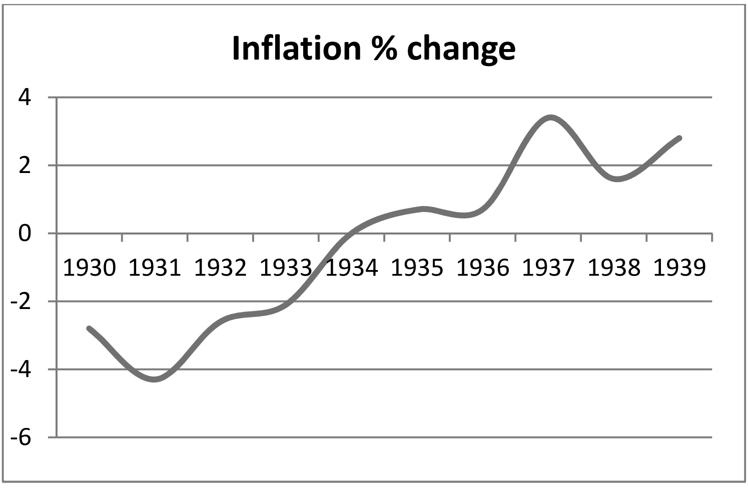
He was the first Chancellor to utilize Budget broadcasts on the radio and in the cinema. His measured and reassuring Budget speeches were commendably short and show a slowly accelerating confidence, reaching a crescendo in 1935, when he told MPs: "Nowhere else can you find a parallel to the results which have been achieved here."

His classical political and economic strategy helped deliver two landslide victories for the Conservative-dominated National Government, in 1931 and 1935. In the first, the Conservatives won their greatest ever landslide: an additional 270 seats, giving them a total of 470 out of the 615 seat House of Commons. In the second election, Labour won back 102 seats, but the Conservatives retained 386 and the National Government – made up of Conservatives, National Labour and National Liberals – still had a large majority for more than 200.



Source: CH Feldstein

It is impossible to evaluate Chamberlain's record without mentioning protectionism, which he himself saw as his signature policy, finally implementing a proposal first called for by his father, Joseph. Now is not the moment to rehearse the relative merits of free trade and protectionism. But it is vital to understand the context of the time. First, British protectionism (which, incidentally, relied on recommendations from a cumbersome Import Duties Advisory Committee run by Sir George May) was a reaction to the Smoot-Hawley tariff implemented by the US in 1930. Second, the traditional criticism of protectionism is that it puts up the prices of imports and therefore hits living standards. But as the chart below shows inflation was actually falling or almost non-existent in the 1930s. This was largely due to the fortuitous improvement in Britain's terms of trade at the time. Commodities, which we imported, tumbled in price; but finished manufactured goods, which we exported, held up much better. It meant that real wages and the standard of living actually rose during the period, even when pay rises were minimal in cash terms. And the levying of import duties was ultimately not felt in the shops. In contrast, in 2011 with the printing of money by Central Banks (including the Bank of England), plus the emergence of China, commodity prices remained high and inflation rose at its fastest rate for nearly 20 years.



Source: ONS

In the long term, protection probably did shelter inefficient industries and contribute to inflation. But in the short term, it provided a welcome boost to the Exchequer. The 10% General Tariff on non-Empire imports brought in after the Ottawa Conference in 1932 helped balance the Budget and reduced the requirement for alternative tax rises. In that year's Budget, for instance, new tariffs helped raise £28 million to fill 80% of the prospective deficit in the public finances. "Where on earth, I wonder," Chamberlain asked the House of Commons, "could we have found this great sum if we had been debarred from the consideration of Import Duties?"

4. THE 1932 DEBT CONVERSION

The greatest triumph of Chamberlain's chancellorship is almost forgotten now. In those days, the British Government's debts were some 175% of GDP (compared to around 68% today), and the single biggest slice of debt was War Loan, raised in 1917. It cost £50 million a year to service, about two fifths of income tax revenue or one eighth of total Government expenditure. This loan was a great favourite with millions of small investors because it paid a reliable income in the form of the 5% annual coupon. It was trading at a premium as it was seen as a safe haven.

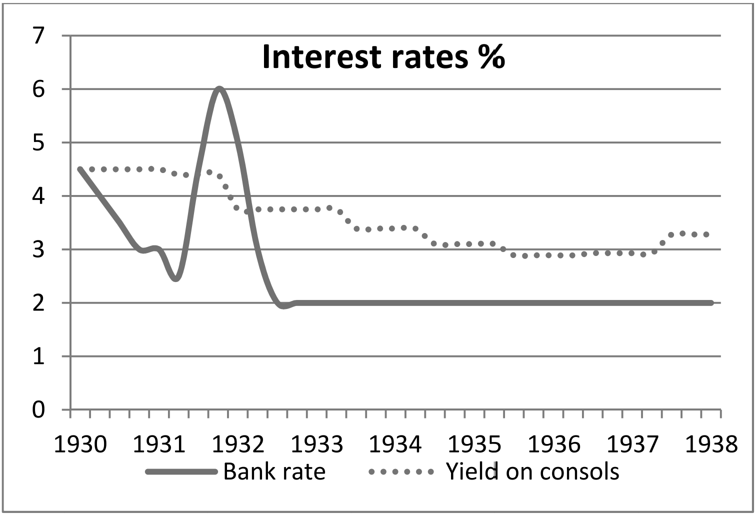
But it also sucked money away from other investments, such as shares, bank deposits or Building Society bonds and thereby effectively forced up commercial interest rates and deprived industry of investment. A conversion of this stock had been mooted on several occasions and was a reported suggestion of John Maynard Keynes. Philip Snowden first introduced the power to do this in the emergency Budget of 1931. But it was Chamberlain who put the policy into effect.

Preparations for this massive exercise took place in secret and on 28 June 1932 it was announced that the Stock Exchange would be open on the Saturday. On 30 June, Chamberlain flew in from a conference in Lausanne and made a dramatic 9.30pm statement in the House of Commons, announcing that investors would be invited to swap their 5% stock for a new 3½% issue. He appealed to investors' patriotism, but those who accepted within a month were to be redeemed in cash at par, plus a 1% bonus. Those who did not accept would be converted into the new stock compulsorily later in December.

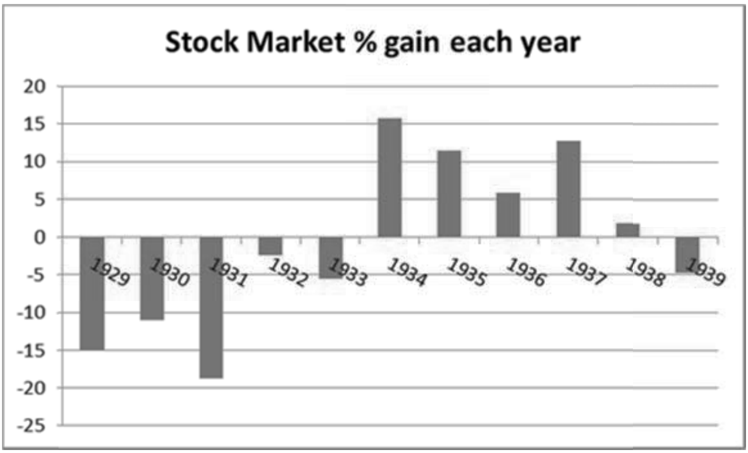
Some 15 million forms were printed and sent out within 12 hours to over two million stockholders. It was accompanied by a blizzard of publicity, including an early talking interview of Chamberlain himself conducted by Pathé. A War Loan Conversion Publicity Office was established which issued daily bulletins of major organisations which had accepted the new terms. Investors were subjected to posters, newspaper advertisements and radio broadcasts. Public support was overwhelming and nearly 90% accepted. Of the institutional investors, only the Midland bank (now owned by HSBC) dragged its feet.

In terms of scale this appeal to the small investor was far larger even than the privatisations of the 1980s. At a stroke, Chamberlain had transformed the Government's finances by reducing interest expenditure by £20 million – and had also enabled the Bank of England, the commercial banks and building societies to embark on a "cheap money" policy which would henceforth underpin the economic recovery. The Bank rate soon dropped to 2% and typical fixed-term mortgage rates declined progressively from 6% to 4½% by 1935.

Another interesting point about the Conversion is how financial markets reacted. Far from balking at the loss of War Loan and the cutting of the coupon, they were emboldened by the orderly improvement in the public finances. Gilt prices, already strong, rose further, as did the stock market in the second half of the year.



Source: Bank of England, Sayers



Source: Barclays Capital Gilt Equity Study

There is one significant caveat to the 1932 War Loan conversion, and that is the low inflation and low interest rates of the decade had disappeared by the late 1950s and the replacement issue proved a notoriously poor investment in the decades to come. Keynes had a premonition of this when he wrote in a secret memorandum to ministers at the time:

> "The public mind… is… a peculiar combination such as could only exist, perhaps, in this country, of a keen desire to make the scheme an overwhelming success, both by personal and by communal action, with an unspoken conviction or at least a suspicion that the whole thing is in truth a bit of a bluff which a fortunate conjunction of circumstances is enabling us to put over ourselves and one another, and that the new War Loan may be expected to fall to a discount in due course. I am not sure that the authorities themselves are entirely free from an idea of this kind."

At the time, however, the War Loan conversion was an outstanding step, skillfully administered by the Bank of England, which showed a remarkable understanding of prevailing investor sentiment and the workings of financial markets.

A related, but less happy, development related to Britain's war debts to the US. This is a complex and controversial subject. But in summary, Britain owed the US £850 million, but was itself owed about £2.3 billion such as German reparations and loans made to Australia, France and others. As Germany would not and could not honour its reparation commitments, Chamberlain proposed a universal cancellation of war debts and reparations. This was not acceptable to the Americans – particularly Congress – and once Germany refused to pay any more, Britain finally refused to pay the US from 1934 onwards. At the time, this caused a huge transatlantic rift, as the standstill agreement meant Britain was still a net loser and even then Congress refused to agree. The war debts controversy is important because although the US Attorney General subsequently held that Britain was not technically in default, this is the closest as a nation we have ever come to that unhappy status.

5. CHAMBERLAIN'S BUDGETS AND THE VIRTUES OF MODERATE TAXATION

A reading of Chamberlain's six Financial Statements is instructive, because what shines through is a clear, classic, political and economic strategy.

- First, to stabilize the public finances.
- Second, to ensure cheap money was available for investment by households and businesses to underpin a recovery.
- Third, to reduce taxes, especially on those with low incomes and families, once it was safe to do so.

This was a sort of proto-Thatcherism, ahead of its time. Not only did Chamberlain build the foundations for recovery, he also established a prosperous, home-owning, middle class constituency for the National Government in general and the Conservatives in particular.

Chamberlain said in his radio broadcast after his celebrated Budget of 1935:

> "There is no magic in it. The application of the principles of sound finance has established confidence in industry. Confidence has begotten enterprise and enterprise has increased employment and profits, so that revenue has increased faster than expenditure."

His strategy is evident in a short summary of his Budgets:

The 1932 budget

This was an austere, conservative Budget in which Chamberlain began by generously praising Snowden, his predecessor. He announced the Exchange Equalisation Account at the Bank of England to smooth fluctuations of sterling on the foreign exchanges following the abandonment of the gold standard and gave some small relief to colonial and domestic sugar producers.

The 1933 budget

Chamberlain reported a deficit of £32 million, much higher than expected, but mostly due to one-offs, such as a final payment to the US for war debt, a default to Britain by the Irish Free State, plus another serious rise in unemployment numbers. But he forecast a surplus for the following year.

The 1934 budget

"We have finished the story of *Bleak House*," a confident Chamberlain told the Commons, "And are sitting down this afternoon to the first chapter of *Great Expectations*." The previous year had seen a domestic economic recovery, driven by business investment and house-building, and Chamberlain reported a large £31 million surplus. He was able to spend this in restoring the 1931 cuts in unemployment benefits and in partially restoring Civil Servant salaries. He finished by cutting 6d off the basic rate of income tax, which in today's terms reduced it to 22.5%.

The 1935 budget

This was his most exuberant Budget, announced in near boom conditions. Another surplus was reported for the previous year of £7.5 million. Chamberlain's buoyant revenues enabled him to announce significant rises in income tax allowances, especially for married couples with children, and a reduction in the so-called half rate of income tax for the low paid. He abolished the unpopular entertainment duty on cheap seats in theatres and cinemas. However, the foreign affairs situation was deteriorating and this was the year in which the first efforts at rearmament began. Chamberlain announced an extra £10 million "for deficiencies in the Army and Navy and for the increase in the Air Force."

Chamberlain's financial statement was followed by speeches of generous praise from the opposition benches, led by Clement Attlee, who welcomed the income tax cuts and the restoration of benefits and salaries.

The 1935 Budget built the foundations for a General Election a few weeks later in May, which returned the National Government with a large majority. Ironically, Labour campaigned on the irresponsibility of increased defence spending and instead proposed a policy of disarmament. Deputy leader Arthur Greenwood described rearmament as "scaremongering, disgraceful in a statesman of Mr Chamberlain's standing."

The 1936 budget

Another small surplus was reported and Chamberlain announced another significant rise in income tax allowances for families with children. He also committed to 13% increase in defence spending and this required 3d to go back on income tax, taking it to 23.75% in today's terms. A Special Areas Reconstruction fund was launched.

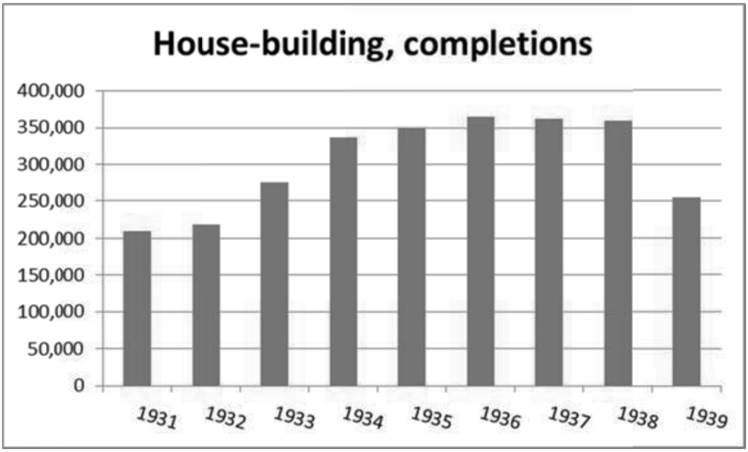
The 1937 budget

Chamberlain's last Budget was dominated by the demands of another large increase in defence spending and the deteriorating political situation in Germany, Italy and Spain. There was another rise in the basic rate of income tax to pay for this, taking it back to Snowden's level of 5s in the £, or 25% in today's terms. Chamberlain also announced a new tax, called the National Defence Contribution, on company profits.

6. HOUSEBUILDING & THE NEW INDUSTRIES

If you were a Luftwaffe pilot dropping your deadly cargo on London in the Blitz, there were two huge new buildings which served as navigation aids south of the Thames: Battersea power station (1933), and Du Cane Court (1937), an art deco block of flats in Balham. Both are physical testaments to the massive investment in housing and infrastructure which took place in the 1930s as the benefits of the cheap money policy flowed through. The power station was part of the National Grid which began operating in 1933, resulting in synchronized high voltage power being brought to nearly every home. And Du Cane Court, still said to be the largest privately-owned block of flats in Europe, is an example of the vast home-building programme which took place. Every one of the hundreds of flats in this splendid development had central heating, constant running hot water, electricity and a built in radio.

These are by no means isolated examples of a huge construction programme. This is the decade in which the Metroland described by John Betjeman was built. Some 2.8 million new homes were constructed in the decade. It is easy to be patronizing about the suburbs, but for millions of families leaving the cities for the first time, their own semi-detached house, which was warm and filled with the latest mod-cons, such as kettles, toasters, and electric irons and even a car in the drive, was a distinct move up in the world. Households, then having very little debt, were prepared to avail themselves of cheap credit and to take out hire-purchase agreements for the first time in order to buy these items and to furnish their new houses.

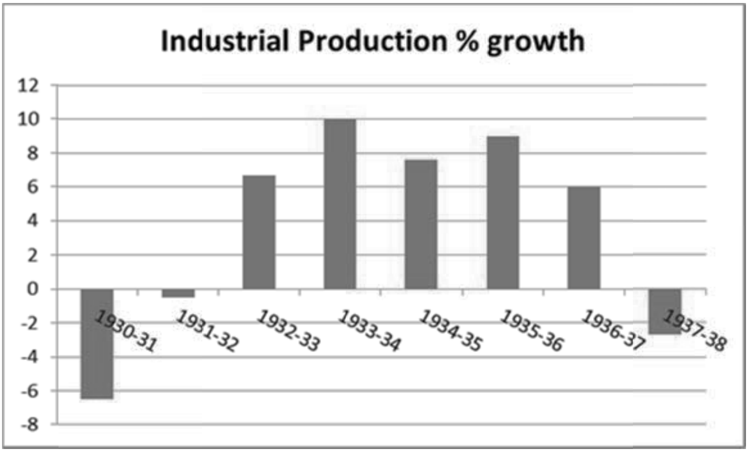


Source: Housebuilders Federation

For comparison, in 2010 Britain completed just 102,570 new homes.

Nor should we make the mistake of believing that the building boom was confined to semis. On the contrary, the 1930s was the high water mark of Modernism in Britain and our towns and cities are adorned with stylish masterpieces, from factories, to stations, to houses.

The 1930s recovery was more than just a household spending boom. If one watches the Pathé news reels of the time, which were screened before the main film in cinemas, one is struck by the sense of optimism which shines through. Indeed, the British news – which to highlight a few random items includes the King opening the giant Queensway road tunnel in Merseyside, Fred Perry winning Wimbledon, and production beginning at the new Dagenham motorworks – is often much more fun than the news emanating from Europe, which comes across as a grim series of strikes, assassinations, marches, and meetings with Hitler.



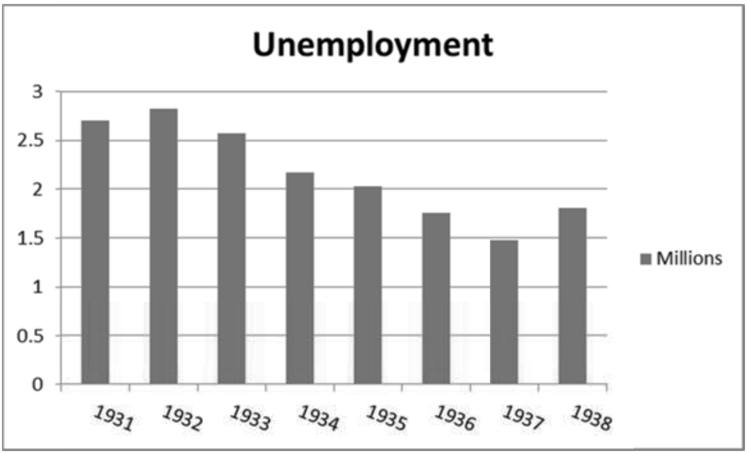
Source: C.H. Feinstein, Robertson

There was also an obsession with speed which was seen as a celebration of technical innovation and optimism about the future. Records, whether by air or by cars, or by boats, were broken repeatedly in a great flurry of publicity. Sir Malcolm Campbell seemed to be perpetually thundering along beaches in *Bluebird*; Cunard's *Queen Mary* held the record from Southampton to New York; a new 10 day flying boat Empire Mail service from Southampton to Australia was launched in 1933 and in 1938 the *Mallard* broke the rail speed record between Edinburgh and London.

Car and aircraft production accelerated rapidly. Firms like Morris, Austen and Humbert were internationally famous names.

Courtaulds dominated the world market for new, manmade fibres, such as rayon and nylon. Herbert's of Coventry was the world's largest producer of machine tools and Sir Alfred Herbert was able to endow the city with an art gallery. Even confectionery production soared and the decade saw the introduction of famous brands such as Mackintosh's Quality Street (1936) and Rowntree's Smarties (1937).

Job creation from the new industries also helped bring down unemployment from 1933 onwards. There is some dispute about how to count unemployment at the time, as the "insured workers" excluded from the workforce those under 16, or over 64 or those who worked in agriculture or domestic service. However, the insured workers measure is the usual one relied on by historians.



Source Feinstein

The pleasures of life were not restricted to sitting at home in a newly-built Tudorbethan semi, with a Morris Minor in the drive, while listening to the wireless and munching Rolos (1937).

There was record cinema attendance and in 1939, 990 million cinema tickets were sold. Paid holidays were introduced (helped by the Paid Holidays Act of 1938), as were holiday camps such as Butlins. Foreign holidays and travel were in reach of richer families for the first time. Contraception was also more generally available, as evidenced by a declining birth rate and the English Rubber Company manufacturing latex condoms from 1932 (available in disposable or reusable varieties).

It was a notable period for a particular style of reflective British modern artists, such as Paul Nash, Edward Bawden, Eric Ravillious, Ben Nicholson, Henry Moore and Barbara Hepworth, to name but a few. There was also a surge in interest in sport and the open air of which the lido is, perhaps, the ultimate expression. Some 180 were built in the decade, including an enormous five acre lido at New Brighton on the Wirrall (sadly demolished in 1990).

7. FIVE LESSONS FOR THE 21ST CENTURY

The 1930s were an imperfect decade and the attempt here to set the record straight about the strength of the overall economic recovery in Britain and the relative buoyancy of the culture should not also be interpreted as belittling the unacceptably high poverty and unemployment in the Special Areas. But one should remember this was in complete contrast to the relative prosperity in the Midlands and the South.

One also has to remember that 80 years ago Britain had some much-needed luck. Despite the initial political positions of all the political parties in 1930, by the end of 1931 the country had devalued and cut public spending. And as the world's largest food importer, the British population benefited disproportionately from the tumble in world agricultural prices.

Despite these caveats, there are some big, simple lessons from the era which we should all learn and apply today.

1. Cut quickly

The first and most important lesson is clear: spending cuts work. After a financial crisis it is vital to have the political courage to take tough action on any deficit in the public finances early, as in 1931. This is necessary to maintain the confidence of individual citizens, businesses and international investors in the British economy, its democratic institutions and its capital markets.

This harsh medicine means both raising taxes and cutting spending dramatically. Although this policy had wide, cross-party agreement in 1931, it was a Labour Prime Minister, Ramsay Macdonald, and a Labour Chancellor, Snowden, who implemented the policy in the National Government formed in August that year.

In the 1930s, the bias was more towards cuts as opposed to the higher levels of taxation that we see today. The quicker the public finances are stabilised, the quicker the economy recovers and the sooner the Chancellor will be able to raise spending and reduce taxes again in the future. The Coalition Government has made a start here in 2012, but if the recovery in the 1930s is anything to go by, it needs to be more confident in its mission.

2. Cheap money

The second lesson is that austerity in the public finances must be offset by a cheap money policy. Chamberlain's 1932 Debt Conversion and the simultaneous reductions in the Bank Rate, should be remembered as great financial achievements. Today, the Treasury and the Bank of England are also pursuing an innovative cheap money policy through Quantitative Easing. Its effects are more questionable. The first round of QE, in the immediate aftermath of the financial crisis, was broadly speaking a success as it allowed financial markets to recover and companies to rebuild their balance sheets. But it is not at all clear that the latest round is working. It is a device aimed primitively at international investors and not, as in 1932, at ordinary households. Monetary growth is currently depressed.

A successful cheap money policy is vital because nobody can be sure precisely where the economic recovery will come from. As unemployment soared in 1931, who could have guessed that aircraft manufacturing, car making, consumer goods, housebuilding would all grow as they did? But encouraged by reasonable credit and a Government which was supportive of business, there was a flurry of technical innovation, new products and investment. The natural creative juices of the economy began to flow.

There is also a democratic aspect. The Conversion of War Loan was agreed to by 2 million people in a formal process. They took the bonus and reduced their income voluntarily. In contrast, the victims of QE – mostly those who have retired recently or who are about to retire – have never been consulted. They have seen their incomes reduced through this complicated policy which has brought down annuity rates sharply.

Today's Quantitative Easing needs to be better scrutinized by Parliament. Is this really the best "cheap money" policy on offer? Is it working as planned? Isn't there a risk that the benefits flow disproportionately to international investors and not into the domestic economy? Should the Bank also be buying commercial bonds as well as gilts? To what extent has it contributed to inflation? None of these questions has been properly answered.

3. Confidence

Third, confidence in the legal and political foundations of the financial system must be restored.

The early 1930s saw some significant fraud trials as those who had misbehaved in the previous decade were brought to book. Clarence Hatry was jailed following the collapse of his investment trust and steel empire in 1930; and Lord Kylsant was sent to prison for issuing a false prospectus for his Royal Mail Steam Packet Company. By contrast, the financial miscreants of the last decade in Britain remain at large and perhaps even unknown. The political will to enforce the law in a just and unemotional manner has been lacking by the authorities in the City and in Westminster. Perhaps they are worried about what they will find.

The 1930s also benefited from the growth of the Building Society movement which was run on small 'c' conservative principles, and was generally trusted by depositors and borrowers alike. By contrast, in 2012, it is hard to say that there is as much confidence in the British banking system as currently constituted. Today's Coalition needs to be bolder in enhancing competition in the banking sector by reducing the market share of the state-backed banks, and by encouraging new entrants.

4. Tax cuts

Fourth, tax cuts work. The sooner the public finances are restored to health, the sooner there will be room for tax cuts, delivering a further boost to confidence and easing the burden on household finances. Chamberlain said at a speech in Birmingham in 1933:

> "There is nobody more anxious to reduce taxation than I am both on personal grounds and out of sympathy with the taxpayer."

He constantly reassured the voters that it was his ambition to provide relief when he could and, judging by the election victories at the time, they believed him.

It is important to be sensitive to the political context and to get the sequence of tax cuts right. Beginning in 1934, Chamberlain instituted carefully targeted tax cuts, for families and the low paid. The Surtax, levied progressively on higher incomes over £2,000 up to a rate of 37.5% on those over £22,000 a year (about £1.2 million in today's money), remained in place. Even so, the wealth creators of the 1930s were treated much better than they are today.

When the Coalition is able to find the money for tax cuts, it should take a leaf out of Chamberlain's book by delivering on its own promise to raise the personal allowance and to recognize the responsibilities of marriage and children in the tax system. As for the 50% top rate – which once national insurance is included is really 52% – it is hard to believe that Chamberlain would have presided over such a punitive rate of taxation and certainly not one targeted at a level which hits even the moderately successful, as it does now.

5. Welfare reform

Fifth, press on with welfare reform. Whatever Chamberlain's merits as a Chancellor, one has to concede that the National Government's approach to curing long-term unemployment in the Special Areas was lacking in imagination. It is impossible not to be moved by the Jarrow march or by contemporary descriptions of urban poverty in the North, such as in the first half of George Orwell's *The Road to Wigan Pier.* The National Government did not make enough effort to invest in retraining, for instance, or to encourage start-up businesses or reconstruction or relocation. There was a famous moment when

Edward VIII toured South Wales and announced: “Something must be done.” Yet not enough was.

From a narrow, classically economic Treasury perspective, this was understandable. But from a political and moral one, it was a failure which tainted Chamberlain’s record and that of his party for years to come.

For this reason, the Coalition must not now be dissuaded from its Welfare Reform measures and its attempts to get the long-term unemployed off benefits and into work. Furthermore, the current rise in youth unemployment, especially the so-called NEETs, who are not in employment, education or training, is clearly unacceptable and a recipe for long term political difficulty.

...and finally

The final point is a more general observation, not only for politicians, but for us all. Financial crises are much more serious than ordinary recessions, because the pattern of an unsustainable boom, followed by a bust, damages the very institutions, such as governments, banks and financial markets, on which a recovery depends. But, as Sir Mervyn King, Governor of the Bank of England, said in January 2012 “There is no need to despair. All crises come to an end.” He is right, as long as we have the good sense to learn from what happened in the past.

That means backing politicians in the inevitably difficult decisions they have to take and not, instead, lending credence to every lobbying campaign which agitates about particular cuts about which we personally disapprove. Everybody has to make sacrifices and should do so confident in the knowledge that the quicker we can all, in Chamberlain’s phrase, put down *Bleak House,* the sooner we can embark on *Great Expectations.*

A NOTE ON SOURCES

This brief essay is built on the shoulders of more substantial work by others. I am especially indebted to Professor Nicholas Crafts of Warwick University for sharing some data with me. Those familiar with the period will recognize I have also relied *inter alia* on RS Sayer's *Bank of England 1891-1944;* HW Richardson's *Economic Recovery in the 1930s*; Robert Skidelsky's *Politicians and the Slump*; Juliet Gardiner's excellent 1930s, *An Intimate History*; Barry Eichengreen's *Gold Fetters*; Liaquat Ahamad's *Lords of Finance*; and Robert Self's new *Neville Chamberlain, A Biography*.

Myths about the 1930s abound and it is time they were challenged. Thirties Britain is frequently portrayed as a universally destitute place, rendered poor and miserable by a heartless, Conservative-dominated National Government.

While the mood was depressing after the financial crisis of 1931, by the middle of the decade, a strong recovery was underway in Britain, mostly due to the successful policies of the National Government. Britain recovered from the Depression faster than any major economy, except Germany.

Lessons for today can be drawn from these policies: spending cuts work, as do tax cuts. Welfare reform must, if anything, be stepped up rather than diluted. And austerity in the public finances is necessary but must be matched by an effective cheap money policy (the impact of today's QE is at best uncertain).

Finally, we should be confident that, in Neville Chamberlain's phrase, the quicker we can put down *Bleak House*, the sooner we can embark on *Great Expectations.*

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