Box A. The slump of the 1920s

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The largest quarterly fall in output in modern times in the UK (so far) was in the second quarter of 1921 when GDP at constant market prices fell by 12.3 per cent. This was directly followed by the largest quarterly increase in output of 13.7 per cent in the very next quarter (see Mitchell *et al.*, 2012, who estimated the quarterly data). Figure A1 shows the percentage quarterly change in output for the inter-war period and we can see that these two quarters dwarf subsequent fluctuations in the rest of this volatile period. In this Box we try to place in context the events of the postwar slump in UK economic activity and understand the likely causes of the prolonged decline and its acceleration in the first half of 1921.

In the immediate aftermath of the Peace, the winding down of the war economy promoted a sharp decline in activity, as did the orthodox deployment of targets for a return to the Gold Standard and a fiscal tightening, which led to a real exchange rate appreciation in the face of declining world demand. In the labour market, wages did not adjust to lower levels of labour productivity and meant that firms laid off some employees. The postwar financial boom was burst by successive increases in Bank Rate. The depth of the recession in 1921 was also in part caused by a coal strike which seems to have accounted for a significant but by no means a complete account of the decline. The end of the strike triggered some growth and it was also fostered by a recovery in global demand, but what became known as the Doldrums ensued as a result of continued tight monetary and fiscal policies.

Figure A1. Quarter on quarter % growth rates in GDP at 1938 constant prices (1920–38)

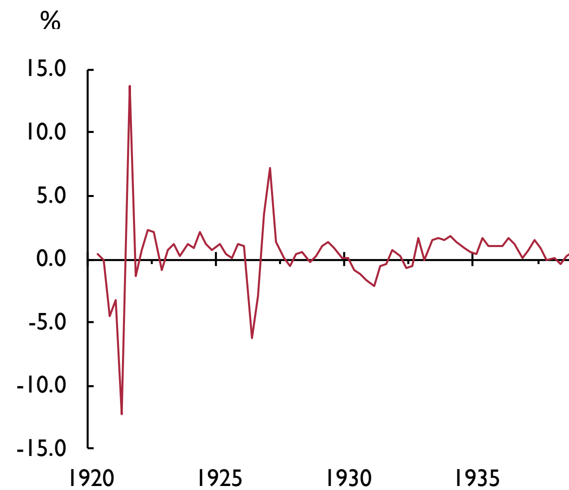
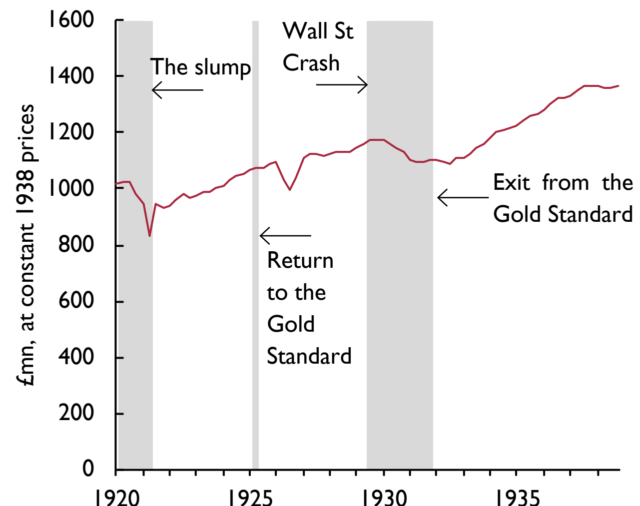


Figure A2. GDP in £mn at 1938 at constant prices (1920–38)



Detail

The shockingly bad second quarter of 1921 was immediately followed by a rapid return in output in the second half of 1921, but the slump had in fact started in the third quarter of 1920 and output did not in the end pass its pre-crisis peak, in the second quarter of 1920, until the second quarter of 1924. At the trough at the end of the second quarter of 1921, output was nearly 20 per cent below its peak. This four-year long recession was termed *The Slump* by Pigou in 1947 and he ascribed much of the cause to the collapse of export markets, whereas Hawtrey placed a lot more weight on tight monetary policy aiming for a return to the Gold Standard in 1925, with Bank Rate raised to 7 per cent in April 1920. Chadha (2014) presents evidence to suggest that monetary policy focussed on the return to the Gold Standard was the dominant cause of the slump.

As it happens the economy weakened well before that historic quarter, from the middle of 1920 until March 1921. And during April and May both industrial production and GDP followed an accelerated decline but rose rapidly again by July-August 1921. The proximate cause was a coal strike that began on 31 March with coal rationing introduced on 3 April. The strike ended on 28 June 1921 and helps explain the sharp recovery in July. The coal strike contributed to the loss of some 85.9 million working days in 1921, which was just over a half of the 162.2 million days lost during the better-known General Strike of 1926. Overall around three quarters of a week was lost by the whole workforce out of some 47 working weeks in 1921, which was around 1.5 per cent of overall labour input that year.[1]

Box A. (continued)

The literature on the 1920–1 recession accounts for the slump in terms of both the demand and the supply side. On the demand side, in 1919, the Cunliffe Committee announced the aim of returning Britain to the gold standard at the pre-war par value, which resulted in contractionary interest rate rises, which brought about a significant real exchange rate appreciation. The pursuit of a reduction in the burden of public debt under the so-called 'Treasury View' also led to large-scale spending cuts to balance the Budget under several initiatives, prehaps most famously Geddes Axe in 1921/2. On the supply side, the literature has stressed the reduction in hours worked with employment and average weekly hours falling from 19.8 million and 52.2 hours in 1919 to 18.3 million and 47.4 hours by 1924, which created a 'wage gap' as productivity failed to adjust. Although these factors clearly acted to provoke a downturn in the economy, the data suggest that the ferocity of fluctuation in 1921 cannot be explained fully by these factors alone and the coal strike offers a further obvious explanation.

Dow (1998) argues that although it was not confined to the UK, the recession was deeper here than elsewhere and nothing comparable occurred in the 1930s or after World War II. It was a special event. The war economy was being rapidly run down, leading to a sharp reduction of some 25 per cent in government expenditure over 1919–20; not all demobilised men could be deployed leading to a sharp reduction in labour supply, which was accentuated as the female participation rate fell. Total final expenditure fell by some 7 per cent in 1921, which was accounted for by large falls in consumer expenditure and net exports, as well as a fall in inventories, and some of the downturn in the cycle was amplified by end of the postwar speculative bubble which also fed into a collapse of world demand. The recovery that started in the second half of 1921 was probably due to some recovery in exports and world demand, a return of stockbuilding and looser monetary policy with Bank Rate cut to 5.5 per cent in July 1921.

As Eichengreen (2004) argues, the overvaluation and concentration of production in high cost industries accounts for much of the decline in this period and although new industries sprung up they did not absorb all the labour shed. British financial institutions and markets were not very well suited for supporting the activities of new small firms and what became termed the 'Macmillan gap' persisted. Arguably, the lack of finance for small and medium sized firms resonates strongly today. The change in attitudes whereby policymakers started to take more active responsibility for economic outcomes can also, to an extent, be traced to this period (Chadha, 2014).

Note

1 See Sheet 3.3A in Chadha et al., 2019. Column U reports that there was 0.69 weeks lost on average compared to a working year of 47.3 weeks.

References

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