1. What were the main causes of unemployment in Britain in the inter-war period?
2. What role did unemployment benefits, structural change and real wages play in causing unemployment/ was it inevitable?

Introduction

Glynn and Booth (1983) note that even at the peak of the cycle, the unemployment rate rarely went below 8%, roughly twice the pre-war rate.

The rise in the "natural rate" of unemployment in the interwar period is perhaps not attributable to a single factor ascribed in the literature, but a combination of them.

Real wages and structural change go farther at explaining high interwar unemployment than unemployment benefits - however, there is also a role for demand side factors, in particular the decision to return to gold, which **Eichengreen (1995)** berates in 'Golden Fetters'.

Aggregate unemployment figures almost always hide the truth, experiences were different according to age, region, sex and industry.

Beenstock et el. (1986) find evidence that the 'discouraged worker effect',

(where agents withdraw from the active labour market as unemployment increases, because they perceive their chances of finding work to be low) to be particularly apparent in women, and especially married women.

Shocks to Aggregate Supply: Real Wages and Labour Productivity

Dowie (1975) finds that the critical change in the 1920s was the fall in the workweek from 54 -> 47 hours (13% fall), which coincides with a sharp increase the real wage.

Dimsdale (1984) calculate a 28% increase in the real wage between 1913 and 1924, which he believed contributed greatly to Britain's lack of competitiveness, and resultant high unemployment.

Beenstock et al. (1984) claim that high real wages after 1929 were the principal cause of rising unemployment during the recession; but also the reason for the recovery of output and employment after 1931, when real wages fell.

This explanation is given in spite of evidence from **Broadberry (1983)** that the supply of labour was very inelastic, and econometric evidence from **Dimsdale (1984)** which supports this.

Solomou (1996) disagrees with **Beenstock et al. (1984)** completely, arguing that real wages were not the problem in interwar period *as real product wage never really got out of line with labour productivity*.

For him, the issue was that labour productivity increases were due to firms shedding the least productive workers (the long tail effect), creating an insider/ outsider problem.

Real wage set by insider negotiations with trade union - this meant that long term unemployed were unable to price themselves back in to the market, which kept the natural rate of unemployment high as a result.

Shocks to Aggregate Supply: Unemployment Benefits

Benjamin and Kochin (1979) explain high interwar unemployment with a benefits story.

They argue that a high replacement ratio (unemployment benefits relative to wages) induced voluntary unemployment (leisure and job search); which is consistent with **Alchian's (1969)** theory of '*search unemployment*',

which posits that people become unemployed as a low-cost means of generating information about the highest value use of their labour services.

Time series regressions run by **Benjamin and Kochin (1979)** suggest that unemployment levels would have fallen by a third to a half if the replacement ratio had remained at its 1913 level.

Their results have attracted criticism from **Ormerod and Worswick (1982)**, however, who believed the sample period to be inconsistent with the causality notion which B&K apply to benefits.

Crafts (1987) finds **Benjamin and Kochin's (1979)** explanation of interwar unemployment to be grossly at variance with much historical evidence,

especially **Alchian's (1969)** 'search model of unemployment', which fails to present a plausible model of the labour market.

Craft's (1987) evidence contradicts this, finding that the longer you are unemployed, the less likely you are to leave unemployment;

which he attributes to psychological changes, loss of skills and adverse signals to employers - resulting in transitional unemployment becoming structural through of process of hysteresis.

Eichengreen's (1987) microeconomic study suggest that the direct effects of benefits on unemployment were minimal.

He also makes the distinction that the unemployment rate for household heads was 8.6%, slightly lower than non-household heads.

He paints a more reasonable picture of interwar labour markets: that if there as voluntary unemployment, it was not among household heads, but rather secondary workers, such as young males living at home.

Shocks to Aggregate Supply: Structural Adjustment

Aldcroft and Richardson (1968) believed unemployment to be mainly structural, a product of overcommitment to declining staple industries like textiles and mining.

Workers lost their jobs in old, labour-intensive staples and were not re-employed in new capital intensive industries, creating transitional unemployment which led to hysteresis.

The '*Richardson hypothesis*' has since been rejected, however, as **von Tunzelmann (1995)** demonstrates that new industries were actually more labour intensive than old staples,

with the ratio of labour to capital at 2 in new industry but only 1.5 in old staples.

Dimsdale (1984) attributes some of the structural unemployment to underlying *sclerosis* by heavy industry.

Powerful unions inhibited new technology in shipbuilding and car manufacture - meaning it was not just a process of adjustment, but rather resistance to change.

Glynn and Booth (1975) also find interwar unemployment to be largely structural.

They observe that the regional locations of many industries (e.g, heavy staples in outer regions, new industries and services around London) exacerbated the maldistribution, as well as the lack of labour mobility between them

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Demand Management: Exchange rate and tariff

Exchange rate policy was an important factor in explaining unemployment fluctuations around the natural rate.

Capie and Webber (1985) note that tight monetary policy was required in order to return to gold at prewar parity. This is because, as **Redmond (1984)** finds, £sterling was overvalued, which meant that monetary policy had to be tightened, at a time when unemployment was approaching 10%.

The return to gold in 1925 worsened the unemployment situation.

Eichengreen (1995) in his book '*Golden Fetters*' posited that the ability of a nation to devalue their currency was a crucial tool in attaining macroeconomic growth through output, employment and investment.

Thomas (1994) estimates that a 10% devaluation would have reduced unemployment in 1928 from 8% to 5%, yet this was not viable, as Britain was bound to the fixed exchange rate monetary system.

Conclusion

Not BK's benefits tale, but rather a more nuanced picture
more about lack of aggregate demand; labour market frictions (some extent union problem).

Ormerod and Worswick (1982) believed **Benjamin and Kochin's (1979)** time series equation to be unstable with respect to their sample period; as the benefits increase occurred after a sharp rise in unemployment during 1920/21. In their time series regression they include these years, yet this is not consistent with the causality notion that they apply to benefits: benefits could not have induced unemployment in these slump years because the benefits to wage ratio was still lower than 1913 levels .