THE IMPACT OF THE GREAT WAR ON THE NEW ZEALAND ECONOMY

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Introduction and Reflection

Economic history sits in an uneasy position in the academy. It is, of course, a discipline in its own right but it is also an adjunct to economics as a source of the testing and generating theories. Its relationship with history is more perplexing. As a general rule, today's historians ignore the relevance of the economy in the histories they write.

I was struck by this in a recent review of the causes of the Great War in which with one minor exception – a mention of Dreadnaughts – there is no reference to the economic contest between Britain and Germany. [1] In 1870 German GDP was about the same size as the French GDP (in common prices) and 30 percent smaller that Britain's. By 1914 it's was a half bigger than France's, and only 10 percent smaller than Britain's. Unnoticed also was that while the British and US economies were of similar size in 1870, by 1914 the US was about double in size of Britain's – a war for dominance in Europe became a world war with the outcome of American hegemony. [2]

Whether this fundamental change in the economic balance of the world deserves only passing reference in the causes of the Great War is a matter I leave to others. But there are lessons relevant to today for we are again experiencing a fundamental change in the world's economic balance – especially with the rise of the Chinese economy. One hopes it does not require a war to settle the new world order.

This paper has a different – if equally pedagogical – purpose. Over the next four years there will be much recalling of the individual events that made up the Great War – the hand-to-hand fighting. But there is likely to be less attention to their long run impact, especially on the economy (technological innovations aside). In contrast, it is my contention that the war experience fundamentally affected the way we governed New Zealand. [3] I shant be surprised if economic historians from other countries come to similar conclusions about their economies.

There is insufficient space for presentation to detail the track of the aggregate economy, not least because the data base is so problematic. The best estimates I have been able to synthesize suggest the economy grew quite quickly in the Liberal Boom to 1908, after which it entered a long period of stagnation in per capita GDP terms which ended 27 years later as the economy came out of the Great Depression (it had, of course, dipped sharply then) and went into the Labour Boom. There is little evidence of a boom in production during the Great

[1] 1. Economic and Social Trust On New Zealand, www.eastonbh.ac.nz An earlier version of this paper was presented to Rethinking War: A Stout Research Centre Conference: 28-30 November 2013.

War (in contrast to the boom of the Second World War) probably because of the withdrawal from the labour force of overseas service personnel. Given that there was not a drop in production (as far as we can tell) productivity must have risen.

Diverting Resources for War

At the heart of a war economy is a substantial portion of the production available to the economy has to be diverted to the war effort. However the modern economic historian thinking about the Great War is handicapped by the lack of a comprehensive data base. Unlike today, unlike that which Jack Baker had available when he wrote his history of the New Zealand economy during the Second World War, there is not the standard statistical framework to analyse the extent to which resources were diverted. So what can be discussed is a bit sketchy.

How much diversion of resources? We dont know with any precision. During the war the troops overseas at any time, plus those in domestic training – amounting to at least 65,000 and even 100,000 men, over a fifth of the labour force – were not available for civilian production, but they were still consuming. Similarly there were workers diverted to producing war goods. There are no annual labour force figures at this time, so we don't know the precise impact of having so many workers unavailable for domestic production. Some of the labour deficit would have been made up by running down the unemployed (although that was not a huge reserve), by drawing women into the labour force (although we dont know how many) and by working longer hours.

That fifth of the labour force in uniform is less than the aggregate resource diversion in the Second World War which according to Jack Baker exceeded 30 percent of GDP between 1939 and 1944. But it is a similar order of magnitude if we add in production diverted to war purposes. While the economists and politicians of the day did not have the detailed statistics they knew there was a challenge to pay for the war from the public purse. The essence of their economic problem was a general cut back in domestic spending.

Suppose then, the diversion to war spending was a third of aggregate output, about the same proportion as in the Second World War. In effect the goods and services available for peace time pursuits was reduced by a third although consumption by those in uniform and war work meant the consumption cut back was not that drastic.

The Fiscal Impact

Where to cut back? Government domestic (current) expenditure was restrained (but apparently only a little) and probably private investment declined (we dont know because the data does not exist). So cut backs in private consumption were necessary and the government raised taxes with its tax revenue trebling between 1914 and including what must have seemed swingeing increases in income tax; the top rate was increased a third from 6.7 percent to 10 percent and there was a super-tax of a further third; land tax went up too. A nice illustration of the broadening of the base was that the number of (income) taxpayers trebled from 14,000 in 1913/4 to 44,000 in 1919/20 (although still a small proportion of the 430,000 adult males).

One of the most radical changes in our tax system occurred over the six years to 1919/20. Income tax made up just 9 percent of total tax receipts in 1913/14, behind customs duties (58%), land tax (13%) and death duties (10%). Six years later income tax was the single largest source of tax revenue at 39%, with the other three behind: customs 30%, land tax 9% and death duties 6%. [4]

Despite the tax increases there was a deficit in the government accounts which was covered by borrowing. In those days the public debt was allocated into categories, including an unproductive 'war and defence'. It amounted to £6.4m in March 1914; by March 1920 it was £86.2m, a £80 million increase in the six years (when annual GDP was around about £125m).

Inflation

In the nineteenth century New Zealand had largely borrowed non-New Zealanders' savings through the London market. From the time of the Liberals, the government began to tap into domestic savings with less recourse to London, partly because of John Ballance's principle of self-sufficiency, partly because London was not as generous with its advances. Access to London's funds would become acute during a major war since Britain was also struggling to divert resources into its war effort. From 1916 New Zealand agreed to raise at home all funds for war expenditure(apart from the costs of maintaining troops in the field).

The ideal is that the government's borrowing soaks up domestic spending power thereby offsetting war expenditure. The reality is that there was accompanying by inflation. Consumer prices rose 67 percent between 1914 and 1920, faster than at any time in recorded history before the Great Inflation of the second half of the 1970s.

The policy response was price controls. It was not entirely a new one, but certainly at a far greater intensity than what had gone before – an intensity which was repeated even more vigorously during the Second World War and during the great inflation of the 1970s and early 1980s. An economist would say, wearily, that the purpose of the inflation – it was an international phenomenon of the times – was to reduce people's real wealth. As the price controls did not address this, they would ultimately fail.

It seems likely that the vigorous price controls of the 1940s reflected those of the Great War. They were trying to avoid a repeat of that inflation and were reasonably successful at the time, for prices in the Second World War rose at only one-third of the rate of those in the first. However, as the history I am writing explains, after the Second World War the suppressed inflation broke out, reducing the value of savings accumulated during the war. Those savings had been used to fight the war, There was no matching investment. So they had to be written off – inflated away.

After the Great War

There was also a loss of manpower in the inter-war period due to the deaths of the 18,500 odd service men. They amounted to over 5 percent of the male labour force while the incapacitated added to the loss. There was no corresponding reduction in those who were not directly contributing to market production - the young, the old, and women working in the non-market sector, so average market incomes across the entire population could have been reduced by between 3 and 5 percent.

There were other changes not least in fiscal policy. Although there were reductions in income tax revenue in the mid-1920s, in aggregate they were not returned to their pre-war levels. [4] Debt servicing aside, the additional revenue was used for public works and social transfers, among other things. Public works in the 1920s are associated with Gordon Coates whose natural political abilities and energy were displayed by spending big on his portfolio, no doubt contributing to his future election as prime minister.

We do not usually think of rehabilitation (repeated after the Second World War) of returned service personnel as a part of the transfer state for it differs from conventional transfer policies because grants tended to be one-off – setting the returned personnel up in business or in a home – and not ongoing (although veteran's pensions are). The rehabilitation schemes after the Great War are usually thought of as a failure but while some of the farm settlements were not successful, the grants for home purchase were a major success.

It is a frequent feature of policy development. There is rarely a single event which initiates what proves to be a major policy, although there can be steps which accelerate its development. The rehab policies after the Great War might be thought of as starting the practice of widespread home ownership. Similarly the war's broadening of the role of income tax was on the way to today's dominant role of income tax in the revenue system. It seems likely that the administration of veterans' pensions was part of the basis for the social security one set up in 1939.

Each of these policies are remembered as First Labour government policies but their early nurturing was by the government of Bill Massey which Michael Bassett sniffily describes as ‘dirigiste’ – the central government actively directing the entire economy. It was; with the exception of the government in which Bassett was cabinet minister and the one which immediately followed, all New Zealand’s governments have been dirigiste. Wars – the Anglo Native ones of the nineteenth century and the world wars of the twentieth – contributed to the dirigiste stance.

The Development of Producer Boards

Any account of the New Zealand economy which does not pay considerable attention to New Zealand's external economic relations is defective. So not only were there profound changes domestically, but external trade relations changed.

New Zealand had been a significant supplier of pastoral products – dairy, meat and wool to Britain – for years before the Great War. One of the few practical reasons New Zealand had an interest in the European wars – colonial filiality aside – was that its shipping routes were compromised.

In addition to the insecurity of its shipping routes the war cut off Britain from some of its external suppliers. Britain and New Zealand negotiated a bulk purchase agreement at agreed prices with the British government accepting responsibility for freight (including any losses from enemy action) and storage.

While at first the exporting was carried out by private agents and the private and cooperative factories, shipping shortages required the coordination of transportation and hence marketing of dairy products, meat and wool. (It was said one ship took 90 days – more than the time to sail to Britain – going from coastal port to port, waiting about for product to be loaded.)

The Imperial Commandeer – as it was called; ‘commandeer’ refers to taking possession or control of something for military purposes – developed in the usual tortuous way of trial and error but by 1917 New Zealand had an agreement with the British Government that all the supplies available for exports would be requisitioned for the British market.

At the end of the war there was a considerable quantity of meat and wool in store. As shipping became available it, plus the normal annual production, was unloaded on the British market, as were South American supplies. Prices collapsed. Private enterprise seemed to have fail again, and the farmers turned to the public sector. In February 1922 the government, with dirigiste (‘Farmer Bill’) Massey at the forefront, passed legislation which established the

Meat Producers Board with very wide powers. Although interrupted by the 1922 election, the Dairy Board was created almost as quickly. [5]

We may ponder whether these producer boards would have been established as early – or at all – had there been no commandeer, had there been no Great War.

Towards Muldoonism

New Zealand's response to the problems which the economy faced during the Second World War was based upon lessons learned from the First, less than twenty-five years earlier. Sometimes the actions were a replication of the earlier war – the commandeer was reintroduced; sometimes they were lessons learned – Peter Fraser, jailed for dissent in 1917, insisted that capital as well as labour would be conscripted this time. In order to avoid the high inflation of the Great War; price controls were more comprehensive.

I have had to revise my understanding of the origins of post-Second World War economic management. I had long assumed that it had been shaped by the economic policies which the First Labour Government had been elected on in 1935 which were a response to the Great Depression. Certainly they were there – there are always continuities and evolutions – but I now think that the highly centralised economic management that was necessary during the Second World War had a major influence for the first forty years after it. I am not sure that New Zealand was particularly more centralised than many other of the war economies but undoubtedly New Zealand was slower to unwind its interventions.

This was most evident in the draconian wage and price freeze which the government of Robert Muldoon introduced in May 1982. The earlier war administrations would have been admiring. Of course, in ways that Muldoon never fully appreciated, New Zealand had moved on. The unwinding of centralised economic control that the successor government – the Rogernomes – undertook might be said to represent the end of the centralised Second World War approach to economic management of forty years earlier, itself a response to the Great War approach to economic management a further twenty-five years back.

Counterfactual history is always difficult especially when the alternative is that there was no Great War, or perhaps New Zealand did not join in. But it is possible to imagine alternative scenarios which could well have led to a very different New Zealand economic management from that we had for the following half century and more, something we might ponder on as we live through historical accounts of the narratives of events then, which ignore the way the Great War shaped our society for years to come.

Endnotes

[1] R. J. W. Evans (2014) ‘The Greatest Catastrophe the World Has Seen’, *NYRB*, 6 February, 2014.

[2] Maddison data base.

[3] Among the texts referred to in the preparation of this paper are

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[4] **Income Tax Revenue as a Proportion of**

Year	GDP	Tax Revenue
1914/15	0.55%	9%
1919/20	4.2%	39%
1924/25	2.1%	21%

[5] The Wool Board was established in 1944. Earlier wool had been involved in the imperial commandeer and in 1921 there was the Board of Trade (Wool Industry) Regulations.