

Recession of 1930-1939: the agricultural cycle in a closed economy

Recession | PEAK: 1934 - TROUGH: 1936.

The 1930s were a period of economic stability in Portugal compared to the previous decade and to other Western economies. This stability was partly a reflection of the reforms implemented in the previous decade and the consolidation of the new political regime. Portugal was not heavily affected by the two major events that marked the Western world at this time: the Great Depression and the Spanish Civil War. The country remained isolated, not only due to its nascent industrial development but also because of political choice. As a result, agricultural cycles were the main determinant of the business cycle. The drought of 1935-36, the negative correlation between the olive and wine cycles, and the aftermath of the Wheat Campaign led the country into a single recession in this decade, between 1934 and 1936.

1. CONTEXT

Internal Context

Politically, the 1930s were marked by the institutionalization of the Estado Novo regime. The National Union emerged as the sole political party in 1930, the same year that the Colonial Act was promulgated. In 1933, the Constitution (which underwent a plebiscite) and the Statute of National Labour officially established the corporatist organization of the regime.

The fiscal and monetary reforms of the 1920s provided stability and solidity to public finances throughout the 1930s. In 1931, a profound reform of the status and role of the Banco de Portugal took place. The Escudo was formally included in the gold standard exchange rate system, fixing its convertibility to the British pound. When the British government made the pound inconvertible into gold, Portugal joined the sterling area, maintaining close-to-parity with the pound throughout the decade. A law passed in 1935 reorganized credit allocation, imposing strong barriers to the entry of new financial institutions, which contributed to the Portuguese banking market experiencing few changes until the 1970s.

Economically, the principle of import substitution prevailed. In agriculture, this doctrine of substitution translated into one of the most significant agricultural policy actions during the Republic, the Wheat Campaign, aimed at addressing the historical cereal deficit that dated back to the late 19th century, with protectionist policies.

In the secondary sector, the industrial conditioning that began in the 1920s was gradually extended to most sectors throughout the 1930s. This involved a set of protectionist regulations that granted the government the power to authorize the opening of companies in each sector, the acquisition of technologies, or the participation of foreign entities in domestic firms. These regulations also encouraged the use of domestic raw materials. It was in this context that, for example, oil refinery

and industrialized production of bicycles began in the late 1930s.

A plan for public investment and expenditure, which would extend until 1950, was approved in 1935 (the Economic Reconstruction Law), focusing on the restructuring and rearmament of the Armed Forces and on economic development. In this latter domain, about 60% of the allocated funds were dedicated to transportation (road and railway networks, ports, aeronautics) and to the modernization of agriculture, approximately 15% of which was allocated to school building construction, and the remainder was distributed among telecommunications, public buildings, urbanization, energy, and mining research. Its implementation started in 1936-37 and it represented an increase of more than one-fifth in current public expenditure and a quadrupling of annual public investment, on average, compared to the first half of the 1930s (Nunes and Valério, 1983). Most investments and expenditures would only be executed in the 1940s, although there was already a modest increase in total investment from 1937-40.

External Context

The Great Depression of 1929 and the contraction of international trade did not have first-order effects on the Portuguese economy through exports or imports because the country still had a relatively closed economy. In the northern part of the country, a small number of banks, more exposed internationally, closed their doors, but the financial sector, in general, had little sensitivity to international financial factors, except for remittances from emigrants. Equipment and transportation machinery industries, which were particularly affected in other economies, were still underdeveloped in Portugal. Thus, the main effects of the Depression on the balance of payments were felt in the sharp decline in remittances from Brazil, for example, due to capital controls in place there; the significant decrease in emigration to all destinations; and the reduction in prices of national raw materials in foreign markets.

Between 1936 and 1939, the Spanish Civil War turned the neighboring country into a stage for a bloody conflict. From a political standpoint, Portugal remained neutral (although it provided facilities to nationalist troops). From an economic perspective, despite some impact on the border regions, Portugal and Spain were largely disconnected and would remain so for several more decades. Other countries like Brazil, England, or Belgium were more relevant for Portugal's external trade. The greatest economic consequence for Portugal from this conflict appears to have been the increase in exports, especially of cork, as the national industry competed with the Spanish industry for the same markets.

2. MAIN INDICATORS AND PROXIMATE FACTORS

Agriculture

Agriculture accounted for 33% of GDP and 54% of employment, on average, during this decade. The main products were cereals, wine, and olive oil.

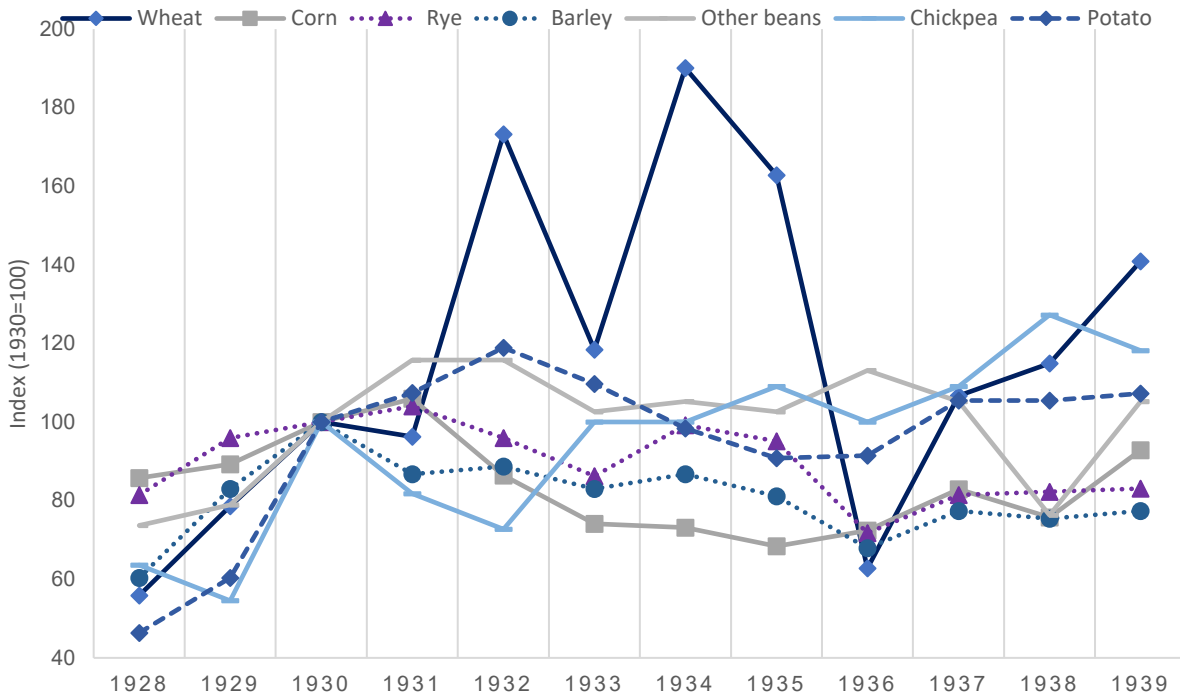
The Wheat Campaign, planned in 1929 and implemented from 1931, had a significant impact on the production of the most important cereal crop in the country during the 1930s (**Figure 1**). Its goal was self-sufficiency in the context of an import substitution policy. It aimed to significantly increase the cultivated area through incentives (production subsidies) and technological improvements (such as providing improved seeds). The government intervened in markets as well by guaranteeing the purchase of national surplus production and setting prices to reduce risk for producers.

Between 1931 and 1934, there was an unprecedented growth in wheat production. This was mainly due to the expansion of land dedicated to wheat and, initially, to the increased productivity of the cultivated area, which almost doubled at that time (Soares, 2005). The subsidies and assured sale of production reached not only large producers but also a significant number of medium and small-scale producers. However, in 1935-36, wheat production abruptly fell to the level of 1928 (prior to the reform). The reasons behind this reversal to the starting point are still subject to discussion. An important contributing factor was soil degradation, showing that the productivity gains were illusory and compromised future agricultural suitability. The fragile fertility accumulated in previously uncultivated lands was exhausted within a few years of cereal cultivation. Another factor contributing to the production decline was a contraction in investment, suggesting an excess of installed capacity in previous years.

Between 1934 and 1935, wheat production remained high in the final successful phase of the wheat campaign, but all other cereals (rye, oats, and maize) experienced significant declines due to the drought that also affected the wine industry. The meteorological year of 1935-1936 was even hotter and drier, further reducing viticulture production as well as cereal production in general. The end of wheat abundance, with the 1936 trough, coincided with decennial lows in rye and barley production, as well as reduced maize harvests (still 30% below the 1930 value). Therefore, no other significant agricultural crop compensated for the significant decline in wheat production.

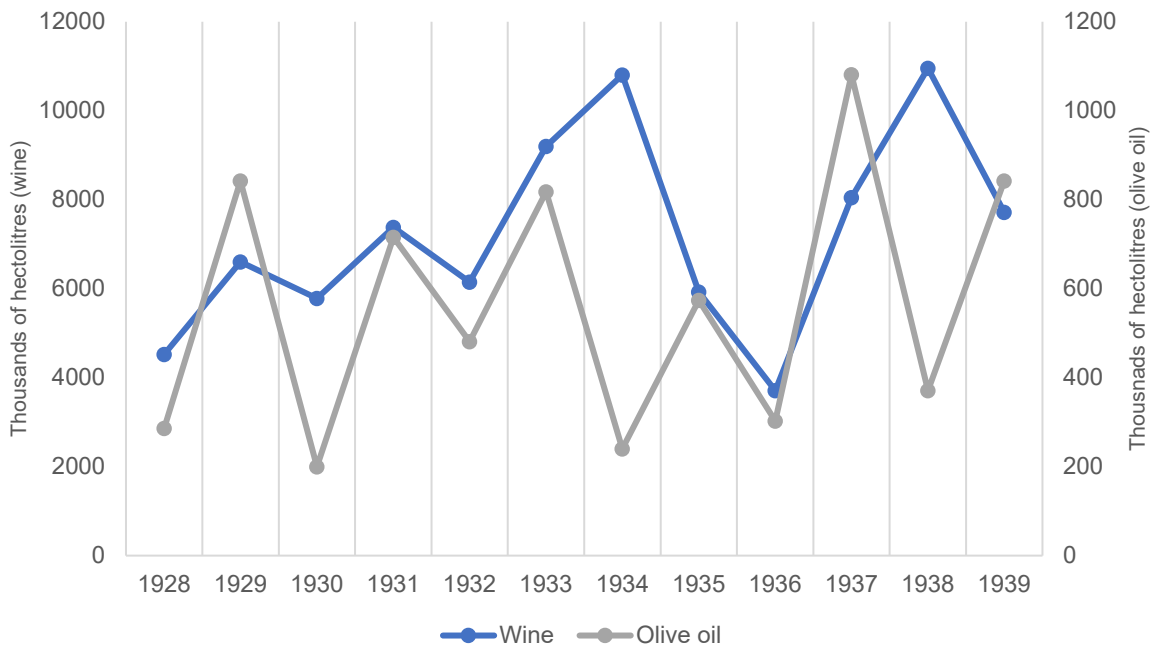
During this decade, the wine and olive oil output followed its natural cycle, with the former being mainly dependent on weather conditions and pest incidence, and the latter on the succession of harvest and off-years. In 1932, 1935, and 1936, wine production decreased due to dry years (**Figure 2**). In the last of these three years (1936), it coincided with an off-year for olives.

Fig. 1 - AGRICULTURAL HARVESTS



Source: Valério (2001).

Fig. 2 - WINE AND OLIVE OIL CYCLES



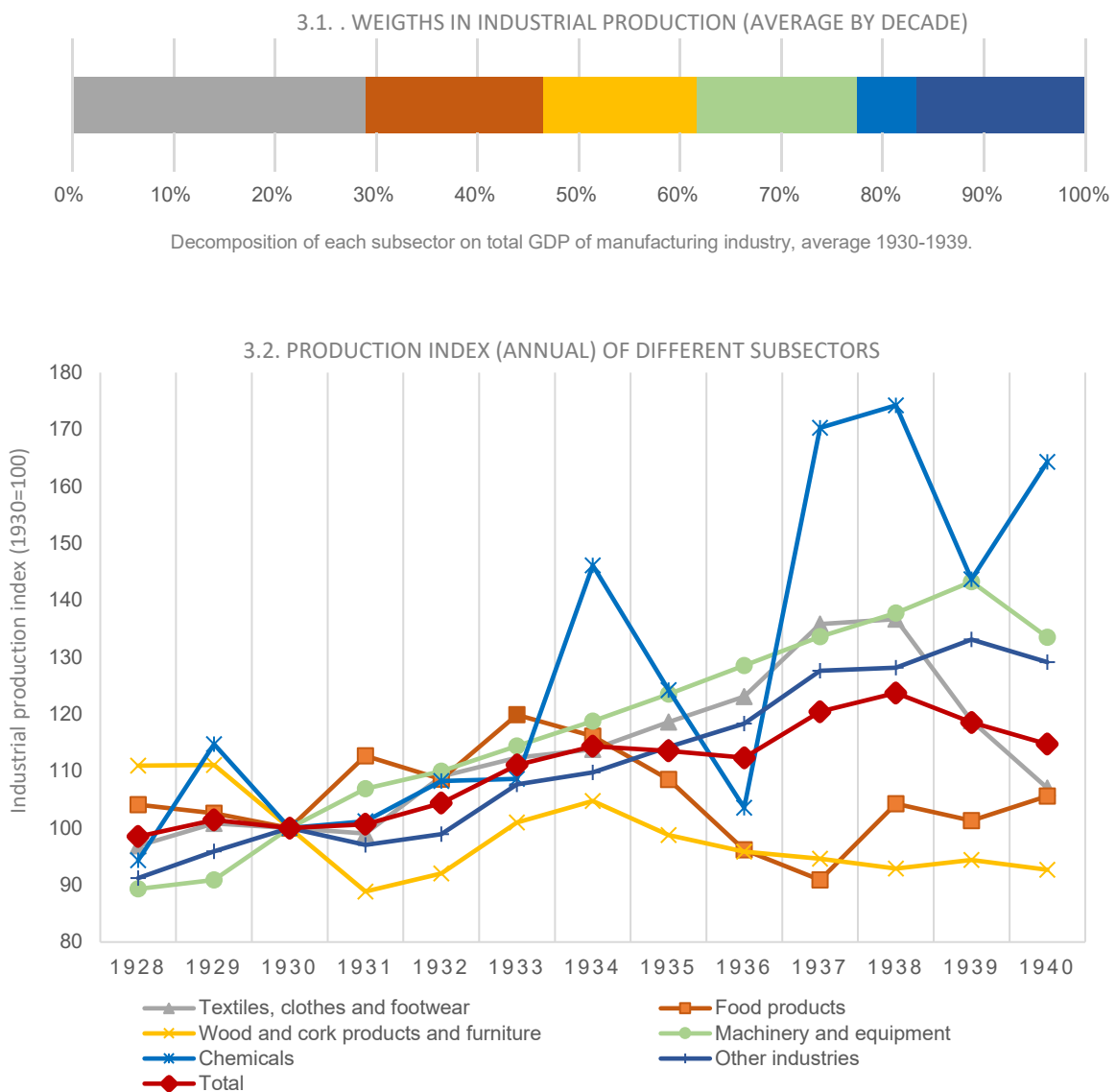
Source: Valério (2001).

Industry

Industry remained secondary compared to agriculture in terms of its weight in the

economy: it accounted for an average of 28% of GDP and 19% of employment during this decade. The productions of various subsectors showed mostly disconnected cycles. Thus, the chemical subsector experienced a significant contraction between 1934 and 1936 (Figure 3), and the food industry (responsible for almost 18% of industrial output) remained in decline between 1933 and 1937. On the contrary, the most important national industry - textiles and footwear - experienced a decade of growth until 1938. Overall, the industrial production index peaked in 1934 and reached a trough in 1936, with a small contraction of 1.8% between them.

Fig. 3 - MANUFACTURING INDUSTRY

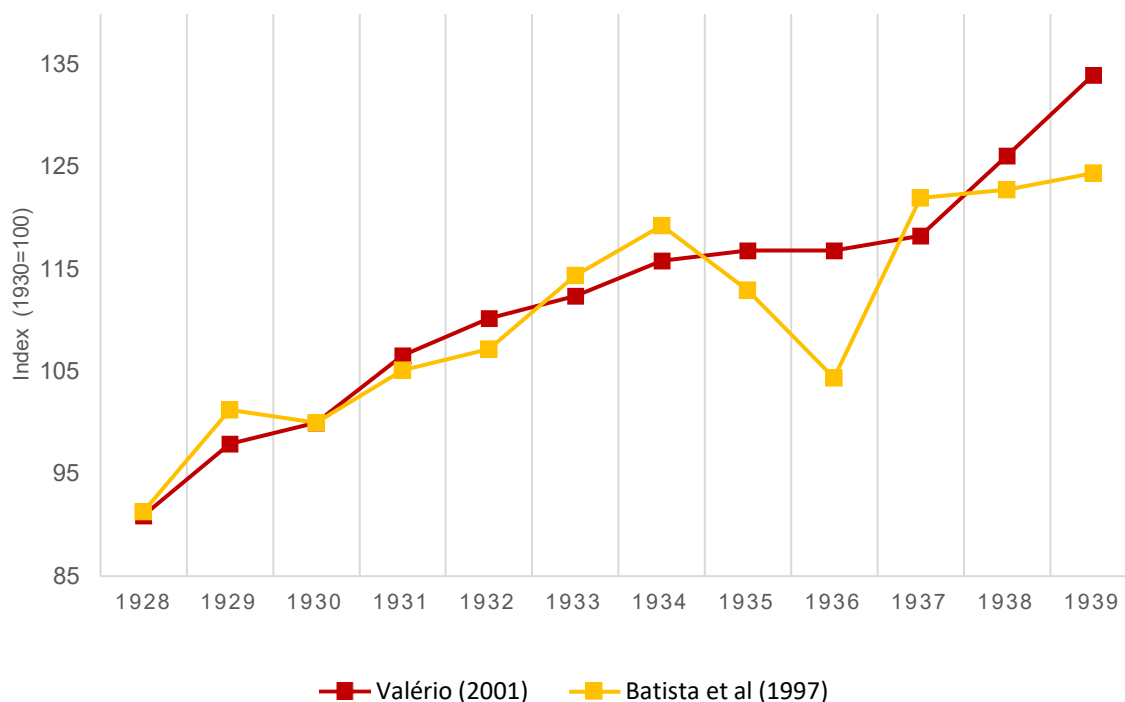


Source: Batista et al (1997).

Changes in Domestic Production

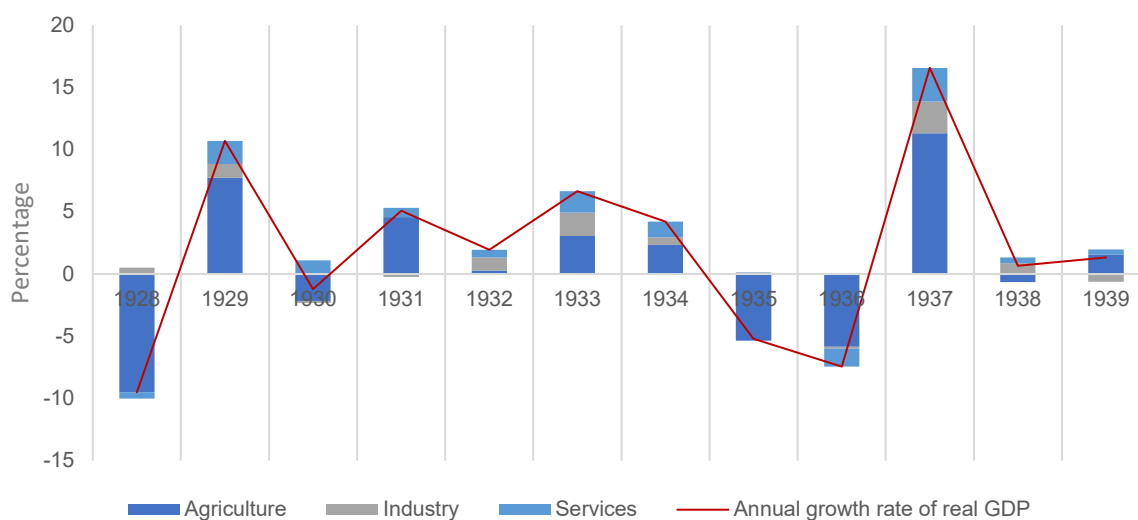
Despite their limitations, the available GDP series, as shown in **Figure 4**, indicate a clear contraction between 1934 and 1936, followed by a very rapid recovery in 1937. As expected in an economy primarily reliant on agriculture, the fluctuations in GDP mirrored those of the agricultural sector (**Figure 5**).

Fig. 4 – AGGREGATE GDP ACCORDING TO TWO SERIES



Sources: Batista et al. (1997): *nominal GDP in Batista et al. (1997)*. Valério (2001): *nominal GDP in Valério (2001)*, retrieved from Valério (1998). The implicit deflator of the respective source is applied to each series.

Fig. 5 - COMPOSITION OF GDP CHANGES (SECTORS)



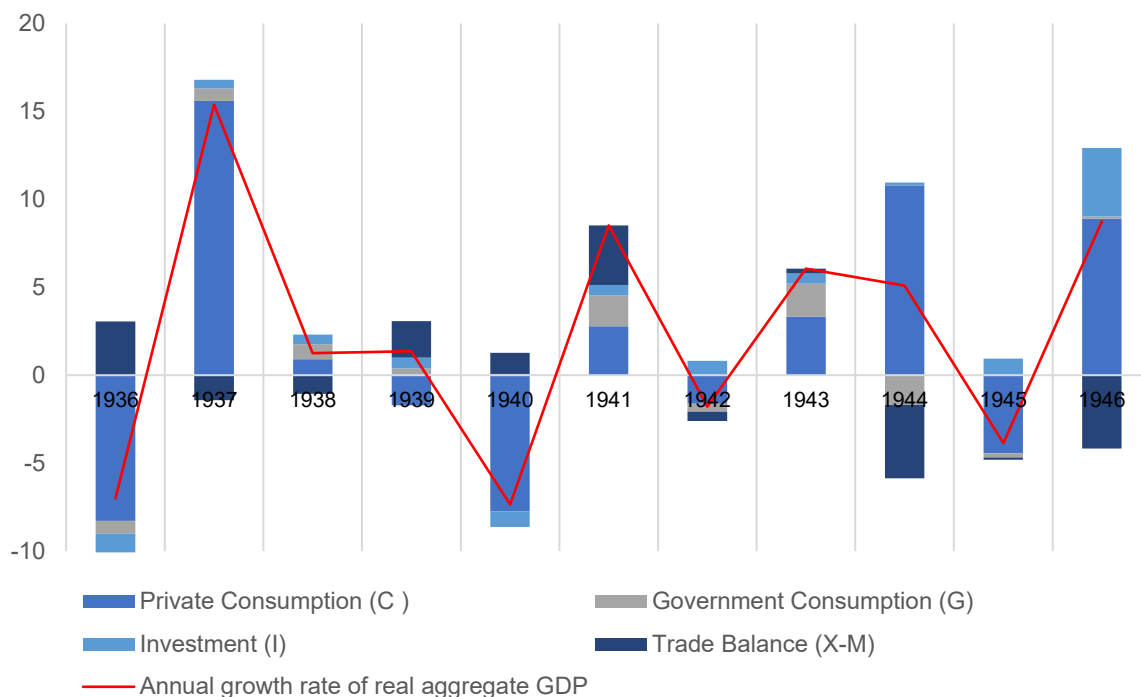
Source: Lains (2003), com base em Batista et al (1997).

Looking at the components of GDP (Figure 6), private consumption and the trade balance moved in opposite directions in 1936, with trade helping to mitigate the recession. An important factor was the surplus of wheat harvest in 1935, which allowed for the export of this commodity in the first half of 1936 for the first time on record. Another contribution to the improvement of the trade balance was the substitution of imports with colonial goods at more favorable prices, such as coffee or sugar.

Finally, the cork industry, which represented about 15% of the value of national exports in its various forms, also experienced a small boom between 1935 and 1937. The domestic industry increased its exports at the expense of Spanish producers, who had been the world's main exporter until then. Portuguese cork exports grew by 3% between 1930 and the 1935-37 harvest, while Spanish exports declined by 16% during the same period (Dias and Moruno, 2006). Portugal established itself from this point onwards as the world's leading producer of cork.

Throughout the 1930s, financial stability created a favorable environment for capital accumulation, which contributed to the increase in the investment rate. It averaged 11%, more than triple the value recorded in the 1910s (Lebre de Freitas, 2005), and without significant fluctuations that would contribute to the business cycle. In fact, from 1937 to 1950, with the implementation of the planned investments in the Economic Reconstruction Law, the contribution of investment to growth was consistently positive.

Fig. 6 - COMPOSITION OF REAL AGGREGATE GDP CHANGES (EXPENDITURE APPROACH)



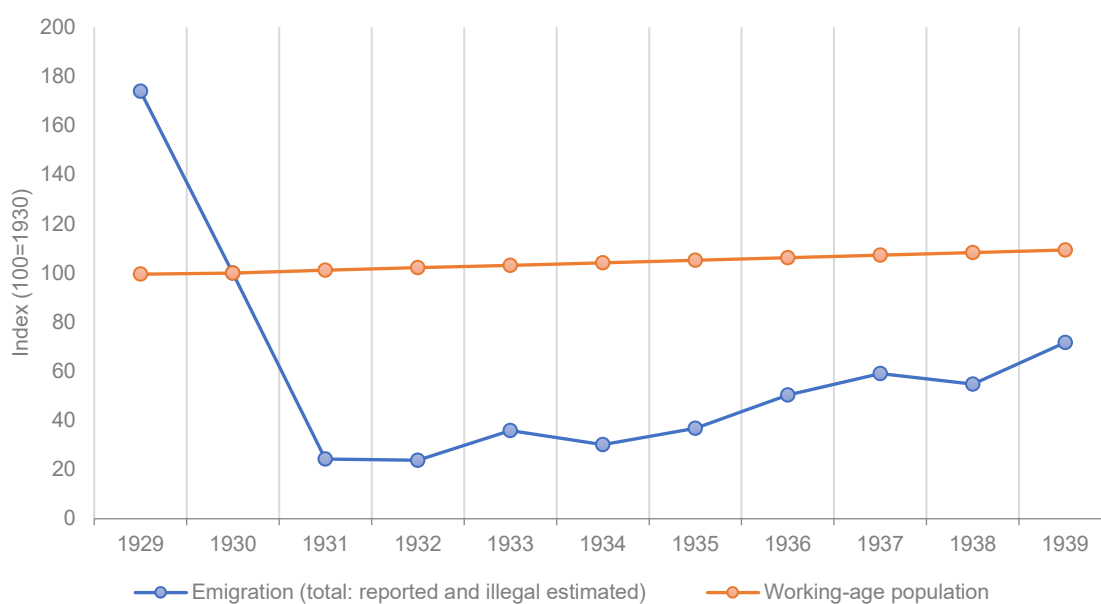
Source: Batista et al (1997).

Emigration

There was a significant slowdown in Portuguese emigration during this decade,

resulting from the international situation, with border closures and a reduction in demand for labor, especially in the Americas, during the Great Depression (Figure 7). In fact, the 1930s is the first decade of the century to record a positive net migration (intercensal) balance, something that would only be repeated in the 1970s and the 1990s. From 1931 onwards, fluctuations in emigration and the active population were reduced. The evolution of these indicators is sometimes associated with external factors. Other times, it reflects what is happening in the national economy, with emigration serving as an escape valve for the deterioration of living conditions for the population. Thus, the data indicate that this is a decade of relative economic calm in Portugal, contrary to what is happening in most other Western countries.

Fig. 7 - EMIGRATION AND WORKING-AGE POPULATION



Source: Valério (2001), based on Baganha (1994).

3. CALIBRATION OF THE PEAK AND TROUGH

Given that the Portuguese economy was predominantly agricultural, the business cycle in the 1930s was strongly determined by the co-movement of wine, olive oil, and cereal production. Each crop had its own factors and cycles, but it is the negative association among them that accurately calibrates a typical agricultural recession.

Therefore, the year 1935 marks the onset of the only recession in this decade, according to the Committee's analysis. Wine production at the end of the year, as well as cereal production in the summer, experienced significant declines that were not offset by the modest increase in olive oil production. This situation worsened in 1936, as the 1935-1936 meteorological year was especially hot and dry, leading to a more intense reduction in cereal and wine production, along with a poor olive harvest. Thus, the Committee concludes that the Portuguese economy went through a significant part of 1935 and the entire year of 1936 in recession.

Considering the predominantly agricultural nature of this recession, the Committee noted that it closely followed the agricultural cycle rather than the annual cycle. Therefore, the peak of economic activity was likely in the first half of 1935, with the harvests in the second half of the year causing a turning point in the cycle. The recession, in turn, persisted until the first half of 1937 when the spring/summer crops were more abundant. In the subsequent years of recovery, public expenditure and investment played a significant role, particularly in driving the growth of 1938 and 1939.

4. CONCLUSION

Portugal experienced relative economic stability during the 1930s, thanks to the consolidation of the political regime and the country's isolation from the outside world. This is surprising considering the large volatility of the global business cycle during this decade and the proximity of Portugal to Spain, which was going through one of the most turbulent decades in its history. It can be attributed to Portugal still being a relatively closed economy and Spain not being a significant trading partner. In fact, it was only after the end of World War II that the global business cycle would have a significant impact on the Portuguese economy.

The recession of 1934-36 can be attributed to three factors. First, the diminishing short-term effects of the Wheat Campaign, with the exhaustion and erosion of newly cultivated soils and the end of surplus wheat production. Second, unfavorable weather conditions for most crops during the meteorological year. And third, a year of poor olive production.

As with other occasions in the Portuguese business cycle, perhaps none of these factors alone would have induced a recession. For example, 1933 was a year of some drought, which resulted in declines in cereal production but not in olive oil or wine production. The Committee considered that there was insufficient co-movement among the relevant (agricultural) sectors to date a recession solely based on that factor. It is worth emphasizing that it is the combination of factors, all associated with agricultural production, that shaped this recession.

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(For a comprehensive list of the sources, see methodological note)

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