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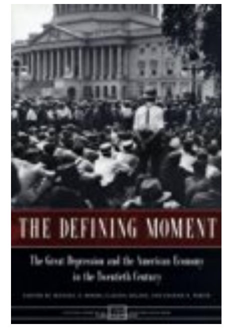
Michael D. Bordo, Claudia Goldin, Eugene N. White, eds.. *The Defining Moment: The Great Depression and the American Economy in the Twentieth Century.* Chicago: University of Chicago Press, 1998. xvi + 474 pp. $60.00, cloth, ISBN 978-0-226-06589-2.



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The "moment" is the Great Depression; what is being "defined" is public policy. The editors have assembled twelve papers from a distinguished cast of authors who are closely associated with their subject. The papers discuss almost all of the programs that persisted from the First and, particularly, the Second New Deals, but few of those that did not. In their Introduction, the editors discuss that this is potentially a controversial hypothesis, but most of the papers simply explain why they agree or disagree with the proposition, and some do find this was NOT a "defining moment." Whether each reader ultimately accepts or rejects the hypothesis may be little more than a matter of definition.

In any event, each of the papers makes a substantial contribution to our understanding of the depression. Most will be widely cited. Many readers, including undergraduates, will want to consult the volume for more than one paper. Thus, in the interest of disclosure, a thumbnail sketch of each of the papers is appropriate. These brief synopses emphasize the relation of each paper to the volume's general theme. Each contains much more.

The collection is divided into four sections of three papers each. The first is entitled "The Birth of Activist Macroeconomic Policy." Charles Calomiris and David Wheelock ask whether the substantial changes in the monetary environment of the 1930s had lasting effects? Those familiar with Wheelock's work will not be surprised to note they find little change in the thinking of the Federal Reserve System. One effect of the New Deal banking laws was to shift power from the Fed toward the Treasury, a shift they feel imparted an inflationary bias, especially when conjoined with the more activist approach to policy that was undertaken concurrently. The most important legacy of the depression was the departure from gold creating "the permanent absence of a 'nominal anchor' for the dollar" (p. 63). The Bretton Woods dollar system allowed the Fed to "stumble" into the inflation of the 1960s, and the continued absence of something like the gold standard "provides an enduring legacy of uncertainty" (p. 63) as to monetary policy in the long run.

Brad De Long notes that the U.S. did not have a fiscal policy in the contemporary sense of the term before the Great Depression. It borrowed heavily during periods of war and tried to redeem the debt as quickly as possible during periods of peace. Government deficits in peacetime were rare until the 1930s, when they proved unavoidable despite the fiscal conservatism of both Hoover and FDR. Yet, even before Keynes, there was an understanding that "deficits in time of recession helped alleviate the downturn" (p. 83). After the second World War, a fiscal policy consensus emerged that De Long characterizes as: "set tax rates and expenditure plans so that the high-employment budget would be in surplus, but do not take any steps to neutralize automatic stabilizers set in motion by recession" (p. 84). That consensus proved hard to maintain: "The U.S. government simply lacks the knowledge to design and the institutional capacity to exercise discretionary fiscal policy in response to any macroeconomic cycle of shorter duration that the Great Depression itself" (p. 82). What has persisted is the willingness to adopt a fiscal policy stance that imposes a cost--perhaps higher than necessary (higher inflation, lower saving and productivity)--to insure that there is no return to Depression-era conditions.

Deposit insurance, the topic of Eugene White's essay, was a result of the Depression and is generally considered to be one of its great successes. Banks became a scapegoat, and the restrictions placed on the banking business diverted part of what they once did to other parts of the financial sector. Banking became smaller than it might have been. Deposit insurance was an attempt to insure the banking system did not fail again. White attempts to estimate bank failures under the assumption that deposit insurance was not adopted. He finds that a stronger, larger banking system would have resulted in lower failure rates and higher recovery rates. Thus, it is possible the FDIC increased bank losses. A more important outcome is that the FDIC changed the distribution of losses. The cost of those losses is now "distributed to all depositors and hidden in the premia levied on banks" (p. 119). Thus, even if losses increased, they were unseen by individual depositors, with the result that a marginal institution remains extremely popular.

The second part, "Expanding Government," begins with a paper by Hugh Rockoff on the expansion of the government sector, largely as a result of a large number of new federal programs. As Rockoff notes, "it is easy to see that there was an ideological shift ... it is harder to see what produced it" (p. 125). This ingenious article looks back at the publications of economists in the 1920s and earlier and finds there were champions for almost all of the New Deal programs. Curiously, one of the programs economists did not endorse, one measure that FDR did not champion, was deposit insurance. When the Depression came and the economic doctors were called, microeconomists had what they considered successful prescriptions. Some part of that must have been conditioned by the role of the government in World War I. But another part is something that Rockoff does not discuss, and it surely is one of the factors producing an ideological change within the profession. Even before the Great Depression, the competitive paradigm was under attack. The merger movement at the turn of the century called into question the assumptions of constant returns to scale and easy entry and exit. The emergence of a consumer society called into question the assumption of homogeneous products. Robinson and Chamberlin's models are independent of the Depression, and what impact they would have had in the absence of the Depression is unclear. It is clear that FDR came into the White House with a mandate to do something, and the economic doctors had a long list of things to try, things that had been used successfully elsewhere.

John Wallis and Wallace Oates argue persuasively that the New Deal had a profound effect on the nature of American federalism through its use of a little used fiscal instrument--intergovernmental grants. Before the Depression, different levels of government operated with a much greater degree of independence than they would thereafter. Intergovernmental grants created the necessity for cooperation that has characterized the fiscal federalism ever since; "fiscal centralization and administrative decentralization" (p. 170). They argue that the new structure was conducive to the growth of government. Like Rockoff, they note the growth of the federal government did not come at the expense of state and local governments; both grew. They show how this new pattern was "the result of the struggle between state and national governments, and also between the president and Congress, for control over these programs" (p. 178). How much of this has to do with a states rights' bias in the legislative and judicial branches, and how much with the depression itself, is uncertain.

Gary Libecap examines the regulatory laws effecting agriculture between 1884 and 1970 and the budgetary expenditures that were derived from those laws between 1905 and 1970. His contention is that "the New Deal increased the amount and breadth of agricultural regulation in the economy and ... shifted it from providing public goods and transfers to controlling supplies and directing government purchases to raise prices" (p. 182). Acreage restrictions and government purchases were the most apparent of what he terms, "unprecedented, peacetime government intervention into agricultural markets" (p. 216). Abstracting from those policies, Libecap asks what agricultural policy might have been in the absence of the Depression. He believes it would have been more like it had been, but that is the result of an exercise in which he subtracts laws passed after 1939 with a direct link to "key New Deal statutes." One wonders how many any of those statutes would have been passed in any event; some represent ideas that predate the depression.

In the first paper of Section III, "Insuring Households and Workers," Katherine Baicker, Claudia Goldin, and Lawrence Katz note that there are three differences between the system of unemployment compensation in the U.S. and elsewhere: experience rating, a federal-state structure, and limitations on benefit duration. The question they address is how that system would have been different had it not been created during the New Deal. There is an implicit assumption the U.S. ultimately would have adopted some form of unemployment compensation in the absence of the Depression. To how many other New Deal programs is this assumption relevant? The authors point to the federal-state structure as the key difference. Their counterfactual system is strictly a federal system with no experience rating, a system consistent with the administration's recommendation. We got the system we did because, "The federal-state structure and the manner in which the states were induced to adopt their own UI legislation assured passage of the act and guaranteed its constitutionality" (p. 261). They criticize the system for not having "changed with the times," but that is no surprise after reading Wallis and Oates.

While most people look to the labor legislation of the 1930s as "a defining moment," Richard Freeman argues that to be defining an event must "lock in certain outcomes that persist ... when, given a blank slate, society could have developed something very different" (p. 287). This test creates two interesting dichotomies in Freeman's story. The first concerns the framework versus the results. The legal framework for private sector labor relations has persisted, and Freeman considers that framework to be "outmoded." On the other hand, the unionization attendant to the adoption of that framework "looks more like a diversion from American 'exceptionalism' ... than a critical turning point in labor relations" (p. 287). The density of private sector unions today is similar to what it was just after the turn of this century; the voice of those unions in national political discourse is barely audible. The second dichotomy concerns private versus public unions. State regulation of the latter has resulted in a relatively stable environment in which collective bargaining proceeds with less confrontation, but that may be because public sector managers are not as accountable to the taxpayers as private sector managers are to the company's profits. In sum, Freeman acknowledges that the framework in which labor relations takes places was defined during the Depression, but that was not a "defining moment" for labor relations.

In their study of the creation and evolution of social security, Jeffrey Miron and David Weil do not examine the role the Great Depression might have played in the program's adoption. Their emphasis is on the evolution of the program since its inception. They find that "in a mechanical sense, there has been a surprising degree of continuity in social security since the end of the Great Depression" (p. 320). That is, there has been little change in what each of the parts does; it is clear the balance between them has changed and that change has had an impact on the economy. As the population has aged, the balance between the old-age assistance component, the basic response to the depression, and the old-age and survivors insurance component has transformed what was an insurance program benefiting few to a transfer program benefiting many.

Doug Irwin's paper on trade policy begins the final section, "International Perspectives." Irwin shows that, during the 1930s, the locus of control of trade policy passed from the legislative to the executive branch of government largely as a result of "the depression as an *international* phenomenon" (p. 326). Smoot-Hawley marked the end of the old approach. By the end of the 1930s, the average tariff rate had decreased from over 50% to less than 40%. In another ten years it would be below 15%. While part of this change is attributable to trade policy, part should be attributable to fiscal policy (a return to the days of the Underwood tariff) as the federal income tax came to play a much larger role, especially in the 1940s. Similarly, the Reciprocal Trade Agreements Act was passed during the depression, but it was not "institutionalized" until after World War II. When, during the war, Republicans moved to seek congressional approval and to protect domestic firms competing with imports, it was clear that the policy changes of the 1930s would persist. Then, after the war, "the new economic and political position of the United States in the world ... made a return to Smoot-Hawley virtually unthinkable" (p. 350).

The paper by Maurice Obstfeld and Alan Taylor is in many ways the most expansive in the volume. They begin by investigating more than a century of data on capital mobility, then propose a framework in which both the downtrend initiated by the Great Depression and the uptrend of recent years can be understood. The framework is a policy "trilemma" faced by all national policymakers: "the chosen macroeconomic policy regime can include at most two elements of the 'inconsistent trinity' of (i) full freedom of cross-border capital movements, (ii) a fixed exchange rate, and (iii) an independent monetary policy oriented toward domestic objectives" (p. 354). To the authors, the Great Depression was caused by subordinating the third element to the second. Under the classic gold standard, monetary policy was concerned with exchange rate stability, not domestic employment, and capital mobility was facilitated. The abandonment of gold led to a system "based on capital account restrictions and pegged but adjustable exchange rates, one whose very success ultimately led to increasingly unmanageable speculative flows and floating dollar exchange rates...." (p. 397).

The gold standard plays an equally prominent role in the paper by Michael Bordo and Barry Eichengreen. To address the question of what the Great Depression meant for the international monetary system, they examine a counterfactual world without the Great Depression--but with

World War II and the Cold War. They assume the gold standard would have persisted through the 1930s, been suspended during the war, and resumed in the early 1950s. Under these assumptions, "the depression interrupted but did not permanently alter the development of international monetary arrangements" (p. 446). The system that did develop in the U.S. was very different than the hypothesized one, but the factors that ultimately led to the collapse of the Bretton Woods arrangements would have caused the collapse of the gold standard--and possibly at an earlier date. Those factors include "the failure of the flow supply of gold to match the buoyant growth of the world economy and hence of government's demand for international reserves" (p. 447). This, in turn, led to questions about U.S. official foreign liabilities and the gold convertibility of the dollar. Bordo and Eichengreen believe that, in these circumstances, a floating system would have resulted leaving us with more or less what we have today. If one accepts the "ifs" in their argument, the institutional structure that emerged in the wake of the Great Depression postponed the transition.

This is a remarkable thought on which to end this volume. Calomiris and Wheelock discuss the Fed's recent emphasis on price stability as a short-run policy concern as a "throwback." Obstfeld and Taylor discuss the deregulation and recent growth of the financial sector as creating a barrier to the reimposition of capital controls. Both discussions concern long-run adjustments the economy has made as a result of the abandonment of gold, but both would have taken place had there been no Great Depression if Bordo and Eichengreen are correct.

The editors point to four common themes supporting the "defining moment" hypothesis (p. 6). "First, skepticism about the efficacy of government intervention withered as the public adopted the attitude that the government could 'get the job done' if the free market did not." It is unquestionably the case that there was a loss of faith in the tenets of the competitive model. While this faith was wavering among social scientists well before the depression, the general bewilderment of the 1930s created a search for someone who was willing to try anything. To paraphrase the late John Hughes, before the Great Depression the federal government only knew how to spend money on rivers, harbors, and post offices. As Rockoff documents, there were a number of other projects waiting in the wings.

"Second, many innovations introduced by the New Deal were forms of social insurance." While much of the First New Deal took the form of World War I programs modified for peacetime use, many of the Second New Deal programs were aimed at ameliorating specific types of suffering, particularly those where successful experiments had been tried elsewhere. Some undoubtedly would have been adopted eventually; the depression meant they started earlier than otherwise would have been the case.

"Third, the character of federalism moved from 'coordinate' to 'cooperative' with extensive intergovernmental grants, giving greater influence to centralized government." This change in form, it is argued, was necessary to get them through Congress and the Supreme Court, but that is not necessarily a result of the Great Depression; the states rights' bias was present much earlier.

"Last, the conduct of economic policy ... changed to give more weight to employment targets and less to a stable price level and exchange rate." These changes in turn imparted what several authors refer to as a bias in favor of inflation, but, in a simple Phillips curve world, what developed was a bias against a return to the conditions of the 1930s. To put it as simply as possible, those who lived through the Great Depression defined for policy-makers then and for their grandchildren today that all possible steps should be taken to avoid repeating the trauma.