H-Net Reviews in the Humanities & Social Sciences

Thomas E. Hall, J. David Ferguson. *The Great Depression: An International Disaster of Perverse Economic Policies.* Ann Arbor: University of Michigan Press, 1998. xvii + 194 pp. $23.95 (paper), ISBN 978-0-472-06667-4; $47.50 (cloth), ISBN 978-0-472-09667-1.

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Published on EH.Net (November, 1998)

The authors assert that they wrote this book for two reasons: disillusionment with how macroeconomics is taught at the college level and a commitment to the Friedman and Schwartz interpretation of the Great Depression that the Federal Reserve was an "incredible source of policy errors." From the first assertion, I infer that the audience for this book is primarily college students, though I think it deserves a wider readership among the economically literate. From the second assertion, I infer that they believe that policymakers had the knowledge to have acted differently. However, at no point do the authors make a serious effort to defend that presumption. I will illustrate their neglect with several crucial examples further on.

The book makes no pretence at being a contribution to our knowledge of the Great Depression and cannot be judged by such a narrow criterion. It must be appraised by a different standard: that is, how well the authors pose the major questions that must be answered and the skill and judiciousness with which they evaluate the current state of our knowledge of the Great Depression, given the audience to which the book is addressed. Lester Chandler's *America's Greatest Depression, 1929-1941* (New York: Harper and Row, 1970) is the only competitor that immediately comes to mind, but Chandler's purpose was not to assess the current state of our knowledge of the Great Depression but to describe what happened. Nevertheless, the audience is apparently the same.

Although the authors stress that the Great Depression was a global event and not simply a U.S. debacle, the emphasis remains on what happened in the United States. For example, output and unemployment in the rest-of-the-world, excluding the U.S. and two European countries, is not described. Hall and Ferguson follow the current fad of placing the gold standard as the central focal point. But what they and others have not done is to show specifically how the gold standard was causally significant for the Great Depression in the U.S. Gold standard considerations played a very minor role, if they played any role at all, in the decision of the New York Fed to advance the discount rate in 1931; moreover, the bank failure rate had accelerated two and one-half weeks before the discount rate was advanced. Only three of the thirteen chapters address foreign country issues. France, Germany, and Great Britain are treated in chapter 4, economic recovery in Germany in chapter 10, and the world financial crisis in chapter 7. The reader can easily come away with the view that what was truly significant occurred in the U.S. and a few European countries and not in the rest-of-the-world.

The Friedman and Schwartz influence is apparent in at least two important respects: the overarching significance accorded the behavior of the money stock and the negative assessment of the behavior of the policymakers, neither of which is critically evaluated. If the jury is still out on the money-income causal nexus, the burden of the historical evidence is too great to warrant any conclusion about the Fed's ineptness.

What is absolutely crucial to appraising the performance of Fed officials is to know the extent of their knowledge of the determinants of the money stock. Whether or not they could have offset the increase in the currency-deposit ratio turns on what they knew or did not know about the role of the C/D and R/D ratios as determinants of the money stock. The authors set out the

modern textbook version of the determinants of M: $M = \{(1 + cd)/(cd + rd)\}B$ but they say nothing about the origins of that equation. The currency-deposit ratio was not fully modeled until 1933 in a pair of articles by James Harvey Rogers and by James Angell and Karel Ficek.[1] Rogers' formal framework had appeared in an earlier book, *Stock Speculation and the Money Market*,[2] which was completely ignored by the economics profession. Less formally, Benjamin Strong, Governor of the Federal Reserve Bank of New York, introduced the currency-deposit ratio in the Stabilization Hearings in 1926 [3] and even earlier in The Report of the Joint Committee of Agricultural Inquiry in 1922.[4] Although Strong's testimony includes a simple expansion process with a C/D ratio, this is by itself a mighty thin reed on which to hold the Federal Reserve System accountable for not forestalling a decline in the money stock between 1929 and 1933. Neither Friedman and Schwartz nor Hall and Ferguson have demonstrated that knowledge of the determinants of the money stock was available to Fed officials. In its absence the case for the Fed's ineptness collapses.

Friedman and Schwartz have made a distinguished contribution to our understanding of the Great Depression, but Hall and Ferguson's uncritical acceptance of some of their historical interpretations of particular episodes reveals a lack of acquaintance with more recent contributions. For example, the authors repeat and apparently accept the Friedman and Schwartz view that had Benjamin Strong lived Fed policy would have been better. But that is no longer a defensible hypothesis. The Fed did in 1930 exactly what it had done in 1924 and 1927–reduce the indebtedness of the New York Fed to $50 million. It worked in 1924 and 1927; it did not work in 1930! Moreover, there are no defensible grounds for criticizing the Fed's behavior for ignoring the demand for excess reserves when raising reserve requirements in 1936 and 1937. I know of no American economist who had any knowledge of a demand for excess reserves.

In attempting to explain the slow recovery from the Great Depression, the authors pay no attention at all to Michael Darby's unemployment estimates.[5] He maintained that the slow recovery from 1934 to 1941 was a fiction–there was a strong movement toward the natural rate after 1935. There are good reasons to question Darby's estimates, but no good reasons for completely ignoring them.

Hall and Ferguson appear to be carried away with their negative assessment of Fed policymakers. At one point they refer to the camps of the unemployed and destitute peoples as "Federalreservevilles" instead of "Hoovervilles." Neither appellation is apt. It is obvious that both go far beyond what either the historical of statistical evidence warrants. The tone is stridently judgmental.

The book may very well succeed in rejuvenating moribund students who are trying to master macroeconomics, but the authors fail to present a convincing case that Fed policy was an "incredible sequence of policy errors."

Notes

[1]. James Harvey Rogers, "The Absorption of Bank Credit," *Econometrica*, 1933, Vol. l, 63-70; James Angell and Karel Ficek, "The Expansion of Bank Credit," *Journal of Political Economy*, 1933, Vol. 41, 1-31 and 152-93.

[2]. *Stock Speculation and the Money Market*, Lucas Brothers: Columbia, Missouri, 1927, pp. 53-62.

[3]. Benjamin Strong, Hearings Before the Committee of Banking and Currency, House of Representatives, 1926, 69th Congress, parts 1-2, 334-5 and 422.

[4]. Agricultural Inquiry: Hearings Before the Joint Commission of Agricultural Inquiry, 1922, 64th Congress. 1st Session.

[5]. "Three and a Half Million Employees Have Been Mislaid: An Explanation of Unemployment, 1934-1941," *Journal of Political Economy*, Vol. 84, 1-16.

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Citation: Elmus Wicker. Review of Hall, Thomas E.; Ferguson, J. David, *The Great Depression: An International Disaster of Perverse Economic Policies.* EH.Net, H-Net Reviews. November, 1998.

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