The Great Depression of 1929-1933
Facts, Theories and Lessons

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Econ541- Economics - Rutgers

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The Great Depression in a graph
Friedman and Schwartz (1963)
Eichengreen (1992)
Recent developments (DSGEs & etc.)
Facts and figures of the Great Depression

- Employment: -43%
- General Prices: -32%
- Personal income: -47%
- Stock prices: -84%

source: NBER Macrohistory
Program

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- It contains no sophisticated econometrics; instead, it slices the data in various ways and considers almost every detail of the economic environment to address issues of exogeneity, reverse causality, spuriousness etc.
"Prevention or moderation of the decline in the stock of money, let alone the substitution of monetary expansion, would have reduced the contraction’s severity and almost as certainly its duration."

Source: Friedman and Schwartz (1963) and NBER Macrohistory
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m = \frac{c + 1}{c + e + r}
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where \( r = RR/D \) is the required reserve ratio, \( c = C/D \) is the currency ratio and \( e = XSR/D \) is the excess reserves ratio.
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Clearly:

\[
\frac{\partial m}{\partial e} < 0 \quad \text{and} \quad \frac{\partial m}{\partial c} < 0
\]
F&S: so...what happened?
1929 crash: NY Fed seeks scape from "real bills" straitjacket
F&S: Chronology of events and policy actions

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1933: full blown bank panic, nationwide bank holiday, supension of gold convertibility, creation of FDIC w/ Glass-Steagall ('33).
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- F&S dismiss the Gold-Standard restriction as explanation for this (so does Bordo et al (2001)).
Comparison with ’08 crisis (from F&S, 1963)

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As in ’08 too, the NY-Fed (Gov. G. Harrison) led the charge towards "unconventional" monetary policy.

Unlike ’08, then the NY-Fed faced great resistance within the Fed. To F&S this was a major obstacle: they argue that the NY-Fed had a better understanding of the problem.

As in ’08 high-profile bank fails (BoUS in Dec. 1930) and a plan to rescue it failed just as in ’08.

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Cooperation: "rules of the game"
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Discount rate differential: BdF - BoE

(source: NBER Macrohistory)
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Discount rate differential: US commercial paper - BoE

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![Discount rate differential: Reichsbank - BoE](source: NBER Macrohistory)
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The GS system becomes vulnerable to a reversal...which eventually happens as a consequence of stringent Fed policy among other factors.
Eichengreen’s "Golden Fetters" (1992)

U.S. Net Capital Outflows

source: Statistical Abstract of the United States, US Census Bureau
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Additional issue: Interwar gold exchange standard, which meant that minor deteriorations external accounts could be amplified quickly if foreign central banks chose to alter the composition of their foreign reserves.

Eventually countries break the peg: Britain, Sweden, Denmark, Finland, Norway, (1931), US (1933), Belgium (1935), Italy, Netherlands, France (1936).

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  Empirical evidence money multiplier effects of bank failures (as in F&S) are not enough to explain the size and duration of crisis. The number of banks operating at the end of 1933 was only just above half the number that existed in 1929. The banking problems of 1930-33 disrupted the credit allocation process; the collapse in credit did not merely reflect fall in deposits but also:

  1. Progressive erosion of borrowers’ collateral relative to debt burdens.
  2. Fear of runs drove banks into assets that could be used as reserves or for rediscounting.
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Some context:

- Original Fisher's debt-deflation: when debts are called-in
- …re sales & contraction of deposit currency
- …fall in goods and asset prices
- …further pressure on nominal debtors
- …further fall in asset prices etc.

Main problem with argument: Debt-deflation is "just" redistribution (large macro effects require in marginal spending prop.)

Modern view uses a similar mechanism through asymmetric information (principal-agent models):

- Borrower's net worth falls
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Bernanke and Gertler (AER, 1989) and the financial accelerator:

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- Bernanke (JMCB, 1995) section 2.2 explores the role of price deflation and nominal wage stickyness in the GD.

source: Eichengreen and Sachs (1985)
Bernanke’s contributions (with co-authors)

There’s an important distinction between real debt and wage deflation: renegotiation proofness.

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Why did nominal wages fail to adjust?
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Why did nominal wages fail to adjust?

- Link between debt-deflation and nominal stickiness (political economy and other arguments)
Program

- The Great Depression in a graph
- Friedman and Schwartz (1963)
- Eichengreen (1992)
- Recent developments (DSGEs & etc.)
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Historical Statistics of the U.S. 1789-1945 (Census Bureau).
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World Gold Reserves:
Additional stuff

- Gold cover ratios:

![Graph showing gold cover ratios for France, United States, and United Kingdom from 1928 to 1932.]

- [back]