Paul Oliva

ECO 467 Literature Review: The Crash of 1929 and the Great Depression

12/01/2010

There is a massive amount of economic research that exists regarding the Great Depression. Such research has become especially relevant in today's struggling economy. Using research regarding the Great Depression, policy makers have devised differing methods of approaching our modern economic issues, from a $787 billion stimulus package composed of tax cuts and government spending to a $600 billion central bank purchase of treasury bonds. Regardless of what one's opinion is of these methods, it is clear that today's policy is greatly influenced by the works of past academics who researched the Great Depression. This literature review will cover just a few of those sources.

The Great Contraction, by Milton Friedman and Anna Schwartz, is a prominent example of past economic research influencing modern day economic policy. Ben Bernanke, Chairman of the Federal Reserve, has referenced this and other works by Friedman numerous times in speeches. His approach to monetary policy likewise shows a distinct adherence to Friedman's ideas. In The Great Contraction, Friedman and Schwartz outline what they view as the causes of the Great Depression. It is easy to identify the indicators of economic downturn that were present: a drop in productivity, a drop in stock prices, falling money stocks, and increasing unemployment. What is more difficult, though, is to identify the cause and effect chains that led to these conditions. Friedman and Schwartz take on the latter task.

Friedman and Schwartz see mismanaged monetary policy as the main culprit in bringing about the Great Depression. In 1928, for example, the business cycle had reached its trough and there was little to no chance of inflation, a climate that modern economists would not deem conducive to tight monetary policy. Contrary to what modern theory would prescribe, the Federal Reserve, in an effort to curb the use of credit for stock market speculation, raised interest rates and greatly reduced its holdings of government securities. The results of this tightening were falling incomes, prices, and productivity. Friedman and Schwartz go on to detail other periods of monetary mismanagement that occurred from 1929-33, using detailed historical evidence to support their findings. The main lesson that one can take away from The Great Contraction is that monetary policy is a powerful force in the economy and that a central bank should place promoting stability on the top of its priority list.

John Kenneth Galbraith's The Great Crash is another historical account of the events leading up to the 1929 stock market crash and the Great Depression. Rather than dwell on monetary policy and other complex economic concepts that may be difficult for the layperson to grasp, Galbraith focuses on the environment at the time: an economic climate that was rampant with speculation and brokers buying stock on margin, a political climate that encouraged deregulation of markets, and a business climate that was conducive to greed and deception. Galbraith details cases of wealthy businessmen withdrawing from the market while still announcing to the public that the market was still good, with the result being huge losses for the average person. Galbraith also dispels the myth that "almost everyone" in the US was invested in the stock market at the time of the crash. In reality only a small portion of the American public were invested in the stock market. Overall, Galbraith does an excellent job of dispelling the many misconceptions surrounding the 1929 crash, while at the same time giving us a new historical account of the events leading up to and immediately following it. His book is the best overall account of the crash for the general reader.

Rainbow's End: The Crash of 1929 is another detailed narrative of the events leading up to Black Tuesday, the day in 1929 when the stock market bubble burst, and its after-effects. The scope of the narrative begins with World War I, detailing America's newfound role in the global economy. Klein continues by giving an extensive account of the 1920's boom-times that led to the formation of the bubble; the growing popularity of stock and security trading, the sharp divide between the major Wall Street players and the average American, the ever increasing level of greed, and the incestuous relationships between politicians and big business. The crash, which brought an end to one of the most economically prosperous decades in American history and ushered in a prolonged depression, is not viewed by Klein as being a one-time event that triggered an economic collapse. Contrary to popular belief, he explains that the crash took place over the course of 20 days, October 23 to November 13, 1929, a span in which the Dow lost 39 percent of its value. By March 1930, however, the Dow had regained 74 percent of these losses. Klein therefore does not see the crash of 1929 as the immediate cause of the Great Depression. Instead, he sees the shadow of uncertainty it cast as being the major culprit. Likewise, he argues that to fully understand the causes of the crash one must understand the historical context; this was a time when new technologies—electricity, the automobile, motion picture, and radio—were changing the lives of average people in ways previously unimaginable, so if one wants to understand the crash then they must understand the era as a whole.

World War I was a turbulent era for the American economy. Production skyrocketed in order to meet wartime demand for food and goods. As a result of this increased demand, inflation boomed and became a mainstay in people's economic fears. The end of World War I was also wrought with economic uncertainty, but allowed enterprising automakers and industrialists to capitalize and reap hefty profits as demand for automobiles reached an all-time high in 1920. Moreover, the war bond programs introduced during the war introduced many Americans to buying securities for the first time Particularly striking is Klein's description of the disconnect between the average American worker and the rich –and super-rich—investors. The common interpretation of the roaring 20's in history is that it was a boom time for all, with widespread prosperity. Klein's description of the blatant manipulation of the market by an elite few, through bribery and other underhanded tactics (most notably, a New York Daily News writer who received payments in exchange for promoting certain stocks in his column), casts a dark shadow over the era and forces the reader to view the 1920's market as being rigged in favor of the elite, wealthy investors.

Though Klein goes into great detail in his description of the events leading up to the crash, his interpretation and explanation of its causes is sparse. His description of the crash as a "perfect storm" is unsatisfying and leads to the conclusion that the crash and ensuing depression were simply a culmination of random and unpredictable events. One glaring omission is the absence of significant consideration of the effect of the Federal Reserve's monetary policy before the crash. It has been argued--most prominently by Milton Friedman--that the uncertainty surrounding Fed policy led to a snowball effect which resulted in the crash. Rainbow's End is a good read for someone who is interested in learning more about the sequence of events and people that contributed to the crash of 1929, but for someone who is seeking an analysis and explanation of the causation chain leading up to the crash, the simple explanation provided by Klein is inadequate.

The Day the Bubble Burst, by Gordon Thomas and Max Morgan-Witts, focuses on the people behind the 1929 crash. In their work Thomas and Morgan-Witts give fascinating narratives of the many colorful figures related to the crash. Richard Whitney, president of the

New York Stock Exchange at the time, is painted as a crook by the authors, skipping out of work early on the day before the crash to go to the racetrack. John D. Rockefeller is also portrayed in a negative light by the authors, despite the fact that they describe his efforts to help stabilize the market. Joe Kennedy, grandfather of John F Kennedy, is also given a poor outlook by the authors as he profited greatly from the crash. All in all, The Day the Bubble Burst is an enlightening and entertaining account of the people involved in the crash, but it dwells too much on specifics and does not give enough background information. Additionally, there are many times in the book where the authors' bias against big business is evident.

Amity Shales' The Forgotten Man: A New History of the Great Depression is another narrative account of several people involved in the Great Depression. Her main objective in the book seems to be a critique of the government intervention that occurred during the Great Depression and the presidents who oversaw the intervention. Shales is very critical of those who would label Herbert Hoover a "do nothing," noting that during his presidency he enacted numerous fiscal measures intended to stem the growing crisis. Her benign attitude toward the oft maligned Hoover is contrasted by her increasingly critical view of Roosevelt and his "Brain Trust", who masterminded the New Deal. While Shales' scathing review of government interventionism is welcome to free market economists and libertarian-leaning individuals, there are times in her book when her bias toward business interests and against government intervention become glaringly evident. As such, a critical reader is forced to view her book with a certain degree of skepticism.

The Great Depression has fascinated scholars for years. The people, the markets, and the policies of the time will remain controversial for as long as men study economics. What was learned from studying this tumultuous period has effected modern policies, and it is very likely that in the future today’s policies, markets, and people will be studied in a similar manner.

Bibliography

Friedman, Milton, and Anna Schwartz. *The Great Contraction.* Princeton: Princeton University Press, 1965.

Galbraith, John K. *The Great Crash.* New York City: Mariner Books, 1955.

Klein, Maury. *Rainbow's End: The Crash of 1929.* New York: Oxford Press, 2001.

Shlaes, Amity. *The Forgotten Man: A New History of the Great Depression.* New York: Harper perennial, 2008.

Thomas, Gordon, and Max Morgan-Witts. *The Day the Bubble Burst.* New York City: Doubleday and Company, 1979.