The Crash and Its Aftermath: A Review Article

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In *The Crash and Its Aftermath,* Barrie A. Wigmore presents a detailed chronology of financial markets from "Black Thursday" in 1929 to President Roosevelt's "100 days" in 1933. The book's strength is in its consideration of bond markets, including the U.S. Treasury, corporate, municipal, and foreign bond markets, as well as (to a lesser degree) commodity markets, in addition to money and stock markets. Nowhere else can as complete a financial history of this time period be found. The book's weakness is its underlying theme that the Great Depression was caused by an unbroken string of negative shocks which pounded financial markets and the U.S. and world economies into ruin.

Wigmore begins with the fall of stock prices that took place from October to November 1929. This reflects his belief that the first negative shock causing the Great Depression was the speculative boom of the late 1920s which, on margin financing, raised stock prices to historic highs. Then, when reality inevitably burst this bubble, stock market prices tumbled, and tumbled, and tumbled, and took everything down with them.

The view that overspeculation during the late 1920s caused the Great Depression has been subscribed to by many contemporaries of the Depression and can be found in a number of histories. Among those holding this view have been conservative economists such as Benjamin Anderson and Keynesian economists such as John Kenneth Galbraith as well as officials of the Hoover administration. Galbraith, in *The Great Crash,* wrote "the collapse in the stock market in the autumn of 1929 was implicit in the speculation that went before. . . . This was the way past speculative orgies had ended. It was the way the end came in 1929. It is the way speculation will end in the future."

Wigmore makes this argument by gathering a voluminous amount of

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Review of Barrie A. Wigmore, *The Crash and Its Aftermath: A History of Securities Markets in the United States, 1929–1933.* Contributions in Economics and Economic History, Number 58. Westport, Conn.: Greenwood Press, 1985.

data relating market valuations of stocks to book values of assets and reported earnings. But, accounting data are significantly distorted by inflations and deflations. Using replacement cost estimates of assets and earnings, John Ciccolo and Christopher F. Baum have demonstrated that market valuations of stocks were no more optimistic during the late 1920s than they were during the mid-1960s. While both the late 1920s and mid-1960s experienced peaks in the stock market, the bull market of the 1960s was not followed by a crash and a depression. Something other than or at least in addition to the bull market of the 1920s must have caused the crash and the following depression.

Wigmore seems continually to touch on, but never grabs hold of, the overwhelming deflationary forces of the late 1920s and early 1930s. In his final chapter, he does indicate that "price level changes had an important impact." But, he never really analyzes the origin of falling prices: Why were commodity prices falling? And, was the Hoover administration's response of exhorting support of prices and wages appropriate?

Looking back, the obvious cause of the deflationary forces of the late 1920s and early 1930s was the (only temporarily successful) attempt by the United States and Great Britain to stabilize prices at levels well above their pre–World War I levels. During World War I, as during most wars, inflationary finance was used to pay for a substantial fraction of greatly increased, mostly war-related, government expenditures. For most belligerents, this was accomplished by suspending the gold standard and printing new paper money. For the United States, this was accomplished by monetizing the inflows of gold from the warring nations that had suspended. In the two cases the results were the same: a doubling of prices over a short period of time.

After the war, the United States and Great Britain had a decision to make: whether to stabilize their currencies at their prewar values or to make permanent some or all of their war inflations. The decision was made, explicitly in Great Britain, to only partially deflate prices *and* to resume the prewar gold parity. The same decision was made implicitly in the United States by attempting to stabilize prices at a higher than prewar level.

A new twist on the gold standard was supposed to enable the world supply of gold to support these higher prices. This new twist was the substitution of a gold bullion standard for a gold coin standard. In this way, gold would be taken out of circulation and hoarded by central banks so as to enable them to issue a greater quantity of money. Furthermore, only the United States and Great Britain were supposed to actually "back" their currencies with gold. Other countries, such as France, Germany and Italy, were to back their currencies with sterling- and/or dollar-denominated liquid assets.

This new gold standard did not work for two reasons. First, at the prices of the 1920s, it was not profitable to mine gold. Thus, the supply of new

gold was insufficient to finance expansion of world trade at the new "permanent" level of prices. Second, France, Germany, Italy, and other countries resumed convertibility, increasing the world demand for gold reserves.

By the mid-1920s, the increasing world demand for gold and the diminished supply of newly mined gold resulted in outflows of gold from the United States. The Federal Reserve responded by "immunizing" these gold flows. That is, in spite of the outflow of gold, the Federal Reserve maintained the quantity of money relative to domestic economic activity in order to stabilize prices at their new "permanent" levels. By the late 1920s, the amount of "free gold" available to the Federal Reserve fell to near zero. By the late 1920s, it would have been clear to an astute observer that the United States would have either to devalue or to deflate.

Unfortunately, the Hoover administration as well as many economists and industrialists confused the prosperity of the 1920s with the new "permanent" level of wages and prices. Thus, they mistakenly refused to lower wages and prices, choosing instead to "share" employment, on the outset of deflation, as Murray Rothbard has explained in *America's Great Depression.* (Krooss, pp. 90–91, describes this belief as the "high wage doctrine." Bernanke conducts an econometric investigation of work sharing and wage stickiness during the Great Depression.) Wigmore does refer to Hoover's exhortations to "neither raise nor lower wages," but offers little criticism.

Irving Fisher was convinced that the fundamentals (supposedly including the impact of Prohibition on the American worker's productivity!) indicated that the stock market crash was simply a correction. Even so, in *The Stock Market Crash—and After,* Fisher did address the "Menace of Gold Shortage," noting the outflows of gold, the low level of "free gold," and the fall in world production in gold. The market, apparently, also took note of the scarcity of gold since gold stocks and French-issue gold bonds performed relatively well throughout the Crash. Alaska Juneau Gold and Homestake Mining, two of the many stocks that Wigmore tracks through the early 1930s, outperformed their industry group ("mining stocks") and the market as a whole even though neither company featured any particular financial strength.

Wigmore feels compelled throughout his book to respond to *A Monetary History of the United States,* the history of this period written by Milton Friedman and Anna Schwartz. Friedman and Schwartz argue that much of the severity of the Great Depression could have been avoided if the Federal Reserve had maintained the liquidity of the banking system through open market purchases designed to maintain the quantity of money.

Wigmore absolves the Federal Reserve from the criticism of Friedman and Schwartz by saying, in effect, that preventing bank panics was not the job of the Federal Reserve. To the contrary, the Federal Reserve was established by the Congress after the Panic of 1907 specifically to prevent bank panics. Wigmore argues that even if the Federal Reserve had wished to flood

the banking system with liquidity, it could not have done so because of its need to "defend" the U.S. gold stock. (Of course, the reason the Fed was forced to defend the U.S. gold stock is that it was trying to fix too high a price level for goods and too low a purchasing power value for gold.)

In discussing monetary policy, Wigmore creates a distinction designed to exonerate the Federal Reserve from the criticism of Friedman and Schwartz. Money, says Wigmore, was easy "with narrow reference to the conditions in the money market, such as declining [short-term] interest rates." Wigmore persists in the Keynesian viewpoint, recently restated by Peter Temin in *Did Monetary Forces Cause the Great Depression?,* that short-term interest rates are *the* barometer of monetary policy. Short-term interest rates, like all market-determined prices, impound a variety of information (inflation expectations, liquidity and risk premiums, tax effects, etc.) in addition to the level of and/or change in aggregate demand. The movements of interest rates are simply too complex to be used to identify the impact of monetary policy.

A true gold standard would have required the Federal Reserve to reduce the money supply during the gold outflows of the 1920s. This policy would have lowered prices gradually to their prewar levels. (Such a gradual deflation occurred after the Civil War, enabling resumption of the gold standard in 1879.) Alternatively, once the massive deflationary forces became obvious, the Hoover administration and key industrialists could have urged across-the-board cuts in wages and prices to speed up the process and minimize the impact on employment and production.

Another solution would have been to devalue the dollar in concert with Great Britain's return to the gold standard at a lower parity reflecting the new "permanent" level of prices. Yet another solution—this was Irving Fisher's—would have been to index the gold content of the dollar so that a dollar would always be constant in terms of its purchasing power.

The solution eventually implemented during President Roosevelt's "100 days" involved devaluation, suspension of the gold clause then common in long-term bonds, massive expansion of the money supply (monetarist-style monetary ease), the cartelization of U.S. industry through the National Recovery Administration, the Wagner Act, and a slew of regulatory agencies, and federal social insurance including Social Security—the lot collectively known as the New Deal and designed to insure reinflation of wages and prices.

The response of government to its botched attempt to fix both the price level and the purchasing-power value of gold involved a massive and, as we now know, permanent increase in its intervention in the economy. Of course, those who believe a mysterious succession of negative shocks could have caused the Great Depression are apt to welcome government intervention in the economy. In another time, they would have been the people to sacrifice virgins to allay the gods.

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