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Review of The Great Depression, 1929-1938: Lessons for the 1980's

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The Great Depression, 1929-1938: Lessons for the 1980's. By Christian Saint-Etienne. Stanford, California: Hoover Institution Press, Stanford University. Pp. xx, 134. · $19.95. ISBN 0-8179-7981-6.

In the mere 104 pages of his main text, Christian Saint-Etienne takes on the great collapse of 1929-33, the long but incomplete recovery that followed, the "stagnation" of recent years and the lessons to be drawn for the 80's. To be short and relevant on such big subjects requires precision and incisiveness. Unfortunately the presentation is cliche ridden, replete with murky passages and salient facets of the experience are ignored. The author is apparently unaware of major issues in business cycle, macroeconomic and monetary theory: he gives potted versions of "mainline" Keynesian theory and wears the blinders of neoclassical monetarist theory. As a result the volume does not throw revealing light on the dual questions that make the Great Depression so important: "Can it happen again?" and if the answer is it can, but need not "What policies and institutions will rig the economy so that the odds favor need not?".

The main issue is whether there are systemic flaws in capitalism which make depressions of varying depth and duration normal events or whether depressions result from policy errors, correctable institutional weaknesses, or shocks. Saint-Etienne comes down strongly on the side of policy errors. His case is made by assertion. He ignores systemic flaw views. He assumes that the barter paradigm theory, which shows the possibility of coherence for decentralized markets, somehow proves that a decentralized capitalist economy with a complex monetary and financial

system generates steady growth unless policy errors or maybe shocks intervene.

To Saint-Etienne the Great Depression could not have happened without United States policy errors. In particular the Hoover Administration's tariff policy and the failure of the Federal Reserve to prevent the decline in the money supply were responsible for the catastrophy. As the Secretary of the Treasury and the Comptroller of the Currency were *ex-officio* members of the Federal Reserve Board, this implies that the Great Depression was due to the incompetence of the Hoover Administration.

Chapter III, A Theoretical Appraisal of the Great Depression, is the theoretical core of the book. Saint-Etienne notes that "...whether money...is just a "veil" with no effect on real activity or whether changes in the quantity of money do affect real activity -- is at the core of the theoretical debate in macroeconomics and monetary economics" [p.51]. This neutrality question is also critical in business cycle theory. As Saint-Etienne attaches great weight to the decline in money in causing the Great Depression, he must hold that money was "not neutral" during 1929-33. But aside from appeals to changes in liquidity preference and to keeping resources "...in reserve to face the increased level of uncertainty" [p.53] he does not specify the features of the economy that makes money not neutral. Saint-Etienne comments favorably on Robert Lucas and other rational expectations/market clearing cycle theorists. He seems not to realize that their imperfect information/errors of interpretation

constructs are devices for achieving a transitory nonneutrality of money.

In a modern capitalist economy money is not neutral because (to paraphrase Keynes) the ostensible owners of capital-assets have often borrowed money to become possessed of them. To a considerable extent this borrowing involves banks; money is created as capital-assets are possessed and money is destroyed as borrowers repay banks. The supply of money is not a static multiplier on reserves but emerges out of lending and borrowing by banks and repayments to banks. For this system to function well, the income flows that enable business to pay their debts cannot collapse; profits must be sustained.

The growth of private indebtedness in the 1920's and the collapse of business profits (a corallary of the collapse of investment) in 1929-33 are aspects of the Great Depression that Saint-Etienne ignores. Indebtedness created the environment that made the policies of the Hoover Administration so devistating.

Saint-Etienne offers hope that a Great Depression need not happen again because policy makers need not be incompetent. Given the strange ideological and economic theoretic views that political leaders can hold this is a weak reed on which to lean. Deposit insurance seems to assure that a stabilizing intervention by the banking authorities will be semi automatic. However a policy incompetence view can offer no guidance on how to rig the economy so that "need not" is the likely result.

There has been a systemic change since the 1930's, which lies outside Saint-Etienne's view, that has rigged the game to favor "need not". The

United States government is now much bigger. This means that large deficits occur during recessions. These deficits sustain business profits so that business debts can be paid. As a result a rush to liquidity by banks does not occur. In these circumstances recessions may be steep, but they will not last long.

Like many others Saint-Etienne emphasized the allocational inefficiencies that may accompany big government capitalism. Because his vision is restricted by the blinders of neoclassical theory, he does not recognize that big government capitalism is less vulnerable to Great Depressions than small government capitalism. As a result Saint-Etienne is not able to learn the lesson that the past half-century teaches: the economic game can be rigged so that a deep depression need not occur.

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