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The Great Contraction

1929-1933

The Great Contraction 1929-1933

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(Resolution adopted October 25, 1926,
as revised February 6, 1933, and February 24, 1941)

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Experience in controversies such as these brings out the impossibility of learning anything from facts till they are examined and interpreted by reason; and teaches that the most reckless and treacherous of all theorists is he who professes to let facts and figures speak for themselves, who keeps in the background the part he has played, perhaps unconsciously, in selecting and grouping them, and in suggesting the argument post hoc ergo propter hoc.

ALFRED MARSHALL

Preface

THE collapse of the United States banking system during the course of the business contraction from 1929 to 1933 and the failure of monetary policy to stem the contraction had a profound influence on men's ideas. In the worlds of scholarship and policy alike, these events led to the view that monetary phenomena primarily reflect other economic forces and that money plays at most a minor independent role in economic affairs. The inference was drawn that policy designed to prevent or moderate economic fluctuations must assign major emphasis to governmental fiscal action and direct intervention.

A paradoxical result followed from the influence of the monetary events of 1929-33 in shaping men's ideas about money. The view that money plays only a minor role in economic affairs led, for several decades, to the virtual neglect of the study of monetary phenomena, including the monetary events of 1929-33. Only recently has there been a renewal of interest in this field of study. Accordingly, we were led to devote a lengthy chapter to the climactic four-year period of the Great Contraction in our book, *A Monetary History of the United States, 1867-1960*. Indeed, one-sixth of the book is devoted to just these four of the ninety-four years our analytical narrative covers.

We concluded that the wrong inference had been drawn from the experience of those four years, that the experience was a tragic testimonial to the importance of monetary forces, rather than evidence of their unimportance. The drastic decline in the quantity of money during those years and the occurrence of a banking panic of unprecedented severity were not the inevitable consequence of other economic changes. They did not reflect the absence of power on the part of the Federal Reserve System to prevent them. Throughout the contraction, the System had ample powers to cut short the tragic process of monetary deflation and banking collapse. Had it used those powers effectively in late 1930 or even in early or mid-1931, the successive liquidity crises that in retrospect are the distinctive feature of the contraction could almost certainly have been prevented and the stock of money kept from declining or, indeed, increased to any desired extent. Such action would have eased the severity of the contraction and very likely would have brought it to an end at a much earlier date.

Moreover, the policies required to prevent the decline in the quantity of money and to ease the banking difficulties did not involve radical innovations. They involved measures of a kind the System had taken in earlier years, of a kind explicitly contemplated by the founders of the System to meet precisely the kind of banking crisis that developed in late 1930 and persisted thereafter. They involved measures that were actually proposed and very likely would have been adopted under a slightly different bureaucratic structure or distribution of power, or even if the men in power had had somewhat different personalities. Until late 1931—and we believe not even then—alternative policies did not involve any conflict with the maintenance of the gold standard.

Robert M. Tayler, an undergraduate at Earlham College, who read our book, suggested to us the desirability of reprinting as a paperback the chapter in *A Monetary History* on "The Great Contraction, 1929-33," so that it would be readily available as supplementary reading for college courses that deal with that episode. We are grateful to him for the suggestion and to Princeton University Press for acting on it.

Though "The Great Contraction" is reasonably self-contained and can be understood without reading the chapters that precede or follow it in *A Monetary History*, as a convenience to readers of this paperback reprint, we have included a glossary of terms and full source notes to charts.

One regrettable omission here is acknowledgment of the numerous and heavy debts we incurred to many individuals and institutions for assistance in the course of writing *A Monetary History*. For a partial list, we must refer the reader to the preface of the book.

Comments by Albert J. Hettinger, Jr., a director of the National Bureau, that appear at the end of *A Monetary History* are reprinted here, since they deal mainly with this chapter.

M. F.

A. J. S.