Synopsis

In 1929

~~A half a century ago~~ the world began its plunge into the Great Depression. No single event since the Civil War has had such a profound and lasting effect on the American psyche and on the economic policy.

Between the Civil War and the Depression, laissez faire was the economic order of the day. But the Depression reversed public attitudes because it was viewed as a failure of capitalism. Many people were persuaded that free market capitalism was fundamentally unstable, that government must play a more active role, intervening to correct the instability of the system. This view of history still dominates popular belief and government policy.

The Depression prompted a dramatic shift in professional economic opinion -- away from the long-held belief that monetary policy was a powerful instrument of the economic policy to nearly the opposite view that "money does not matter." The economics profession embraced the new theories of British economist John Maynard Keynes, who offered an appealing justification for extensive government intervention.

According to Milton Friedman, the shift of both public and economic opinion "arose from the misunderstanding of what actually happened. . . the Depression reflected a failure of government, not free enterprise." In particular, it was a failure of the Federal Reserve System to exercise its powers to halt the slide. The evidence is clear "that the Depression was produced -- or at the very least made far worse -- by perverse monetary policies followed by the U. S. authorities."

The recession of 1929 was not really unique in American history. The country had weathered downturns before. The difference this time was the widespread bank failures and the severe monetary contractions that followed. The Federal Reserve had been established in 1913 to avert bank panics. But the Fed failed to use its powers. As the economic contractions continued, people began massive withdrawals from banks. There followed a sharp decline in the money supply, and the falling money supply throttled economic activity. An expanding money supply could have stoped the decline and economic growth could have resumed.

The Fed had the power to prevent the monetary collapse, but it refused to act because of the death in 1928 of Benjamin Strong, Governor of the Federal Reserve Bank of New York and the dominant force in shaping Federal Reserve policy. His death left the Fed without effective leadership and set off a struggle to concentrate power in the Federal Reserve Board in Washington and to downgrade the influence of the New York bank. Thereafter, indecision and deadlock within the Board became the order of the day.

Factors other than monetary policy affected the detailed course of the Depression, but Friedman concludes, "it is. . . inconceivable that the Depression could have ... been as severe as it was if the Fed had acted early to prevent a decline in the quantity of money."

Objectives

After seeing this program, the viewer should be able to

A. define the term "money supply,"

B. explain how the money supply can be decreased or increased by policy alternatives of the Federal Reserve,

C. suggest conventional explanations of the Great Depression's "causes,"

D. explain psychological effects of failure of the Bank of the United States,

E. point out potential problems during the bank panic in a nation that has a banking system using a fractional reserve system,

F. cite evidence that suggests the Depression was exported from the United States to other countries rather than imported from other countries to the United States,

G. suggest policy alternatives legally open to the officials of the Federal Reserve System that might have prevented the recession beginning in 1929 from deepening into a long and severe recession,

H. suggest reasons why policies of government intervention in economic affairs became popular during and after the Great Depression,

I. point out the connection between a nation's supply of gold and a nation's money supply under conditions where the nation is on a gold standard, and

J. explain arguments supporting the view that the Great Depression resulted from a failure of government.