BOOK REVIEWS

A Monetary History of the United States 1867-1960. By MILTON FRIEDMAN AND ANNA JACOBSON SCHWARTZ. Princeton: Princeton University Press, 1963 pp. xxiv, 860. $15.00.

This history of the dollar for nearly a hundred years is a massive piece of erudition, exhibiting the highest scholarly qualities. Immense work must have been involved in its composition.

There are two aspects which may be particularly noted for praise. One is the great detail of the treatment. The 93 years are broken down in various significant ways, *e.g.*, into business cycles and longer trend periods. But there is also a year by year treatment, and sometimes the authors give careful consideration to the succession of events in periods of months or weeks. Often one gets to know the pattern of a particular year with great intimacy. This painstaking approach yields far richer knowledge than could be obtained by a mechanical treatment of long time series. The peculiar circumstances of a year, including, perhaps, institutional changes, are often relevant to a correct understanding.

The second outstanding feature is the high quality of the intellectual approach. Everything is assessed with the aid of well-defined rational criteria. Current or ex post official explanations of events get short shrift, if they do not stand up to critical examination; and many widely held opinions, which have become a sort of stock in trade for commentators seeking to draw illustrations from the past, will have to be abandoned, at least if this book is as carefully studied as it deserves to be. The severe and uncompromising intellectuality of the book makes it exhilarating.

Since the value and validity of much of the text depends on its massive detail, any reviewer must have a hard task. A "sabbatical year" would be required for a final assessment, rather than a beggarly fortnight. But then the reviewer might find himself involved in writing another book. It is to be hoped that this one will form the basis of a hundred Ph.D dissertations by graduates of first class calibre.

It is not possible to do more than select a few themes for discussion. The authors claim that from this piece of history we may learn the lesson that, apart from short business cycle phenomena, there is no regular connection between economic expansion and rising prices.[1]

[1] See pp. 15, 88, 93, 187, 678.

This conclusion agrees with the findings of a United Nations Report, which approaches this problem from an entirely different angle and with entirely different tools of analysis.[2] The U. N. survey of world wide ambit finds no correlation between the pace of expansion in various countries and the degree of inflation present in them. To the extent that American history does in fact provide evidence for this lack of correlation, this is clearly a matter of the utmost importance.

We may take certain detailed points, before reverting to wider themes. The authors attach great importance to the Federal Insurance Bank Deposits, 1934.[3] They conclude their passage on it as follows:

> That is why we regard Federal Deposit Insurance as so important a change in our banking structure and as contributing so greatly to monetary stability—in practice far more than the establishment of the Federal Reserve System.[4]

The authors regard the restrictions on the outpayment of currency against deposits, such as occurred in the crisis of 1907, as a valuable therapeutic measure,[5] and suggest that it might have been useful even in 1930. This must seem surprising to British readers, who have regarded it as a great boon that the Bank of England, under the influence of Walter Bagehot—who is praised in another part of this book—has, by its smooth operations in times of crises, been able to prevent any such restrictions since 1866, and thus greatly reduced the severity of such crises as have occurred, by comparison with the previous half-century.

There is much interesting material on the greenback period. In their summing up the authors say that "The mechanical effects of the purchase of gold abroad" towards the end of the period of inconvertibility "made resumption more rather than less difficult."[6] It is interesting to recall that Ricardo made an identical criticism of the Bank of England when he was a Member of Parliament during the period between 1815 and 1821, the latter date being that of the resumption of sterling convertibility.

There are fine accounts of the silver policies of the late 19th century—incidentally should there not have been a reference to the issue of token silver coins in 1853?—and to the silver policies of the New Deal period, with its unfortunate repercussions on China.

Although the authors do refer to the international scene at many points, one has the impression that they sometimes fail, in their interpretation of American sequences, to give enough weight to the operation

2 UNITED NATIONS, PATTERNS OF INDUSTRIAL GROWTH 1938-1958 (1960).

3 Pp. 434-42.

4 P. 442.

5 Pp. 163-68.

6 P. 697.

of outside forces on the U.S. economy. For instance, should not the world wide deflation of 1873 to 1879 come more strongly into the story? Should there not be some reference to the Japanese silk market in relation to the events of 1920?

At this point mention may be made of the fact that decimal points have been omitted from Chart 41 on page 513, and that lines 14 and 15 are transposed on page 677.

The book has many weighty criticisms of the Federal Reserve System, and these will doubtless attract attention. But is it quite fair to say in summary that its establishment, "intended to promote monetary stability, was followed by about thirty years of relatively greater instability in the money stock than any experienced in the pre-Federal Reserve period our data cover,"[7] without referring to the two World Wars that occurred during the later period? The older system did not have to stand the test of the enormous pressures due to those two Wars. It may be thought also that the authors over-stress the survival in the thinking of the Federal Reserve of the "needs of trade" doctrine in relation to credit policy.[8] Although the authors do cite instances to the contrary, one would suppose that this doctrine did not play a leading part in the formation of policy after 1922.

One would get a more favorable view of the beneficent effect of the Federal Reserve if one confined one's attention to the periods 1922 to 1929 and 1951 to 1964, thereby omitting the periods of wartime stress. But one would thereby also omit the period 1929 to 1939, and some might think that the crux of the matter. There is a fine and highly critical analysis of the episode when reserve requirements were raised in 1936.[9]

But of course the most crucial period of all was that from 1929 to 1933. There is a masterly chapter[10] on this episode, running for 120 pages. The authors bring their inexorable logic to bear upon the feeble inertia of the Federal Reserve in allowing the stock of money to run right down. Open market operations, they hold, should have been undertaken on a substantial scale at an early stage. There is an exceedingly interesting and lengthy treatment of the shift of the balance of power within the System after the Wall Street Crash. The authors hold that, if the New York Bank could have retained the position of leadership that it had in the preceding period, all might have been

7 P. 698.

8 P. 297.

9 Pp. 522-26.

10 Ch. 7.

managed much better, and special praise is given to its two experts, Carl Snyder and Mr. Randolph Burgess.

Perhaps this reviewer may be forgiven for yielding to the strong temptation to introduce a personal note at this point. I had luncheon with Carl Snyder and Mr. Randolph Burgess in the Federal Reserve Bank of New York in the late summer of 1930. I came briefed with statistics and arguments. (I had the good fortune to have given courses of lectures on the Federal Reserve System in Oxford in the five preceding years, so that I knew my way fairly well about their statistics.) With the utmost of my youthful powers I pleaded with them that they should purchase $1 billion worth of U.S. government securities right away. I argued that, if they did not do this, the U.S. economy would infallibly sink down to lower levels, and that the great slump, which was then proceeding throughout the world, would assume unmanageable dimensions and cause wide-spread havoc and political disturbance.

I do not recall if those two experts accepted my figure of $1 billion; it would probably have been inappropriate for them to agree to a specific figure with a youthful stranger (and foreigner). But on the general issue I found that they were in complete agreement with me. They spoke very frankly about the shift of power within the System. They earnestly wanted to pursue a policy of this kind, but could not do so without persuading the Banks of the "interior," and they had so far been unable to persuade them.

Thirty-four years have passed since that, to me, memorable interview. This book sets out in much greater detail the story that Snyder and Burgess unfolded at the lunch table. It is particularly intriguing to me that the authors of this book have named the figure of $1 billion as being the kind of sum that might have turned the tide in 1930. One billion is doubtless a round figure. But what I had in mind, as did doubtless the authors of this book also, was to indicate an order of magnitude.

In their culminating passage the authors refer to the Federal Reserve policy at this time as "inept." The epithet seems justified. While this reviewer does not accept the conceptual background of the authors in all respects, the errors of the Federal Reserve in that period were so flagrant that all who have it in common that they approach these problems in an intellectual way may concur in condemnation.

The authors hold, presumably correctly, that the fiasco of those years undermined the faith of economists in the monetary weapon. If this undermining was due to the idea that the monetary weapon had failed, this was wrong, and indeed absurd. The monetary recipe just was not tried; thus it cannot have "failed." The true moral should have been, "If something like this happens again, let us try the monetary weapon."

On the other hand, the whole development of the world slump, as viewed at the end of 1932, may surely give rise to certain misgivings about the potency of the monetary weapon, unaided. Was it really sensible to suppose that this world wide havoc could all have been prevented if Snyder and Burgess had been able to do what they wished? Would a thing so small in relation to the world wide scene have done the trick? Perhaps it might have. But it does not seem unreasonable to have some doubt. May there not have been more intractable forces, such as the balance between investment and saving in the world as a whole, or lack of balance between agricultural and industrial output? There is a further point. Even if one holds that the Federal Reserve could have prevented the debacle, one might still also hold that, things having slid so far down, as they had by the end of 1932, monetary policy would not have sufficed alone to restore the situation.

Note may also be made of the authors' view that "the monetary collapse from 1929 to 1933 was not an inevitable consequence of what had gone before."[11] There is also some excellent reasoning about the alleged decline in the quality of bank lending in the preceding years.[12]

It is time to turn to certain broader issues. In an analytic history of this kind, much depends on the choice of concepts. There are three fundamental concepts that are in constant use throughout these pages, viz. high powered money, the deposit reserve ratio of commercial banks, and deposit currency ratio in the public holdings of money. The reader would do well to study Appendix B very carefully, before proceeding to read the book.

High powered money, an expression indebtedness for which is assigned to Mr. Randolph Burgess, covers, to put it very briefly, deposits held at central banks plus currency. There is something a little curious in this, since "high powered" suggests, and I think is intended to suggest, a multiple relation between it and the total money stock. But, if this is so, why is currency in the hands of the public included in high powered money? In principle, indeed, all this currency could become the basis of multiple expansion, if turned in by the public to their banks, but not in practice. The reader may not be able to help hankering after a different classification, which would exclude currency in circulation from high powered money, nor to help wondering whether this re-classification would suggest other interpretations in the course of the narrative.

Alternatively, the authors may have made their classification by reference to that part of the whole money stock that is "created" by the

11 P. 699.

12 P. 354.

authorities, along with that based on gold or silver intake. National Bank notes could be included on this basis, although rather precariously, on the ground that the quantity of these depended on the quantity of the specific assets required as cover, the latter being regulated in amount by the authorities. Nonetheless the distinction between National Bank notes (high powered money) and National Bank deposits (not so), both generated by the lending activities of the National Banks, seems not quite satisfactory.

There is a deeper question. The *policy* of the authorities is reflected in the quantity of the deposits held by commercial banks with the central banks, while the authorities are largely passive in relation to the supply of notes, which are provided in consequence of what the public needs in relation to the general economic situation. Do we not need concepts which bring out this difference?

The total money stock is related to the quantity of high powered money, quite correctly, by the two ratios referred to above. These ratios are called "proximate" determinants of the money stock, or sometimes, as on page 684, "arithmetical" determinants. But one has to raise the question whether it is right to think of them as determinants at all; may they not rather be, anyhow in certain phases, residuals?

It is implicit, I think, in the narrative, that the deposit currency ratio is the result of the deliberate choice of the public, as between these two kinds of money holdings. Choice of this sort may indeed play an important part in relation to the long-term trend; it was also doubtless frequently of importance in the U.S. scene when there was a deliberate trek by the public out of bank deposits into currency in phases of nervousness about the banks. A great deal of detail is given on this theme, and this may well be perfectly correct. On the other hand it is unlikely that the second mentioned cause (nervousness about banks) has operated in the U.K. at all during the whole period covered by this book.

Even if deliberate choice by the public determined the deposit currency ratio in many phases of U.S. history, there may also have been variations in that ratio which were strictly residual. It may be noted that A. C. Pigou has a somewhat similar determining ratio, designated *c*, in his famous essay "The Value of Money."[13] This reviewer has always taken exception to this concept, as not representing a genuine choice, and in his own formulation has substituted—of course with consequential changes in the other determinants—"The proportion of transactions that individuals choose to finance by cash." That does seem

[13] Pigou, *The Value of Money*, 32 Q.J. ECON. 38 (1917), reprinted in ESSAYS IN APPLIED ECONOMICS 179 (1923).

to represent a genuine choice by individuals, subject to the existing institutional arrangements.

The trouble about designating the deposit currency ratio as a proximate determinant is that it may be the fortuitous consequence of other forces. Variations in the amount of currency held by the public must be partly influenced by variations in the money value of the National Income, whereas, at the same time, the amount of bank deposits may be determined by the authorities. If, for instance, the authorities reduce the quantity of deposits, the public may be unable to replenish them, so long as the money value of the National Income remains what it is, since it just has to have a certain amount of currency for out-of-pocket expenses. Recent British figures may serve to illustrate this point. Between the years 1954 and 1963 current accounts (demand deposits) at the London clearing banks rose by 10.0%, while deposit accounts (time deposits) rose by 32.8%; current and deposit accounts together rose by 17.6%. Currency in circulation rose by 43.1%. The money value of the National Income rose by 66.1%. Thus the deposit/currency ratio fell; but there is no need to suppose that this reflects any change whatever in the attitude of the public as regards the desirability of holding currency versus deposits. The holding of currency was quite clearly chasing the money value of the National Income upwards; a certain amount of currency is needed to pay wages, do shopping, etc. The much smaller rise in deposits is simply a reflection of monetary policy, the monetary authorities having since 1954 pursued a somewhat cautious policy of expansion, perhaps thinking that liquidity was excessive in 1954. Thus the public have had to make do with less deposits; but they just could not do with less currency, or not to the same degree, and the authorities doubtless provided as much currency as was required by the public for what is in effect small change. It would surely be quite wrong to interpret this change in the deposit/currency ratio as representing any changed view on the part of the general public; it was the direct effect of the authorities not supplying an increase of money in proportion to the rise in the money value of the National Income.

The other determinant is the deposit reserve ratio. This has been absolutely constant in the U.K. since World War II. And it is believed that, behind the facade of window dressing, it was practically constant at a slightly lower level for a decade or more before that War. Now as regards the U.S., there has been a wide-spread view, which is criticised by the authors, that excess reserves reflected the fact that member banks just could not find any means of using this excess money without getting an unbalanced portfolio. The authors contend, on the contrary, that, when excess reserves increased, that was due to a genuine desire on the part of the banks to increase their own liquidity. It may be that the authors are right; but this cannot be regarded as certain. And the fact that the concept is not of universal application may limit its value. There is a rather tortured passage, on page 541, on why the U.S. deposit/reserve ratio rose in 1940 to 1942. May there not be a much simpler explanation than those given, namely that the expansion of the economy, partly due to certain warlike events occurring elsewhere, gave the banks opportunities that they had not had before, of lending more money to their clients?

We now come to a still more far-reaching question, namely that of the velocity of circulation. The authors find cyclical variations in it, a long run downward trend, but also substantial periods of upward trend. There is a very interesting chapter towards the close of the book, seeking to account for the post-war upward rise, admittedly not decisive. The considerations adduced in that chapter may very well be real and important.

But there is another quite different way of regarding the matter. For substantial periods (decades) velocity may itself be the residual. Let us suppose that inflationary pressure prevails, owing to an excess of aggregate demand in *real* terms (propensity to consume and propensity to invest) and that this sends prices up. Let us suppose also a wage-push inflation. But suppose that the authorities do not increase high powered money in proportion. Velocity will then rise, as a residual, as it has done in the U.K. during the last decade.

The intellectual objection to this view is: "Why should people choose to hold less money (in relation to their income, total wealth, etc.)." But they have no choice. Individuals can, of course, sell securities, but this does not affect the total money stock available, although it may raise interest rates. In the period for the U.K. cited above, the yield on consols rose from 3.75% to 5.58%. As a collection, the public cannot replenish their cash balances to the desired level, because the money just is not there. They will have to make do with less. It is not likely that they will fail to place remunerative orders, or to reduce spending below the desired proportion of their income; and prices will go on rising owing to the excess of aggregate demand and the wage push. (The higher rate of interest may have a damping effect on national income, but this may not be nearly sufficient to reduce velocity to its previous level.)

Or take the other case where the quantity of money has become redundant, whether owing to a recession or to a deliberate policy by the authorities to increase its supply. Individuals can buy securities, thereby bringing the rate of interest down. But, as a collection, they cannot get rid of the money. Much has been made in certain quarters of the "real balance" effect of the redundant money, but this can only be marginal. The money will find its way into the hands of firms, which cannot distribute it as dividends because it is for them a capital asset, and they would get into trouble with their auditors if they did so.

Such points of view, which may be associated with the thought of Keynes, are not discussed in this book. Keynes' name, as such, does not appear in the index. This is rather a curious omission in view of the monumental and varied contributions to monetary thought made by Keynes over several decades. There are indeed three references to "Keynesian economics;" but these relate only to an ill-defined body of thought with which Keynes would not necessarily have agreed.

Keynes was always a great believer in the potency of monetary policy, although not regarding it as a panacea; and in this respect he resembles the authors of this book, although he would probably have disagreed with them on the points mentioned above, especially as regards velocity.

While this book casts a strong searchlight on the events reviewed and certainly reveals many new historic truths, it must not be supposed that it throws any light whatever on the issue between Keynes' theories and what is sometimes contrasted with them under the name "classical" theory. The idea—but perhaps no sagacious reader could hold such an idea—that this book makes any contribution towards vindicating this "classical" theory, as against Keynes' theory, is as much a non sequitur as the idea that the events of 1929 to 1933 proved the impotence of monetary policy, and for the same reason. Monetary policy was not attempted in the U.S. in 1929 to 1933; and likewise the authors have made no attempt to interpret the period that they survey in the light of Keynes' specific theories.

Where no attempt has been made, the principles that such an attempt would test cannot have been either confirmed or refuted.

The authors have plausibly explained much that has happened in the century reviewed. They have been modest and scholarly throughout in not over-stating their claims to have given a complete elucidation. It may be that, had they brought the most potent weapons of Keynes' specific theories to bear in elucidating the many episodes and phases that they have reviewed, they would have been able to offer much more convincing and complete explanations at many points. Or it may be that they would not have been able to do so. We just do not know, because they did not try.

I would not end on a note of criticism, but on one of enthusiasm. This is a truly great book. Future historians of these events—and one hopes that there will be many—cannot fail to be deeply indebted to it.

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