László Ohnsorge-Szabó

The Great Depression – Retro Part 2

On the Great Depression in Light of New Research

ABSTRACT: The direct reason for writing this study was to draw conclusions of the Great Depression for the present crisis that started in 2008 and which continues to the present day. My goal is to present international, primarily Anglo-Saxon monographs and studies on the topic that apply methodologies and approaches hardly discussed – in this particular topic in my view – in Hungarian language literature. My conclusion, emphasised in reference to this specific historical event, is that even though financial-economic studies – accompanied by their very own sophisticated methodologies – are essential to understanding global crises, such as the crisis of 1919-1933, they are at the same time insufficient to do so. It is unavoidable to involve broader historical-political context in these studies as well as highly complex social psychological processes that are at the same time of crucial importance and orient the expectations of masses. This is closely related to recognising the limits of knowledge that shape and influence current economic policies.

KEYWORDS: Great Depression, international business cycles, financial markets and institutions, international monetary measures
JEL CODES: A110, F330, F440, F500, N200

DEFLATION

It has become general practice today to trace the crisis or its deepening back to deflation and the deflation-prone international financial system. It would, however, be advisable to call attention to the fact that in the 1920s, deflation policy was not only not considered by many to be part of the problem, but was in fact held desirable, viewed as the cure itself to be used against the artificial inflation of the financial sector and resulting 'excess' investments; as this is what would bring about the era of '*sound finance*' (Botos 198, p. 341; Eichengreen, 1992, p. 301). There was a strongly-supported concept, according to which during World War I production capacity increased at a faster rate than monetary gold supply, and lower prices were supposed to balance out greater money demand caused by increased production and lower money supply caused by the scarcity of gold. According to this argument, in the 1920s central banks blocked this desirable dropping of prices by placing foreign currencies in their reserves and through the 'loose' money supply based on this, which went beyond the rules of the gold standard. On these grounds, those in support of deflation felt that the 'disciplining' of the system, the failure and consolidation of companies over-expanded during the process as well as the curbing of employee demands was in order. According to this argument, 'excess' liquidity had to disappear from the system.[1] Among those who supported this view were such people as *Lionel Robbins*, *August Hayek* or US Secretary of the Treasury at the time, *Andrew Mellon*. This viewpoint was also a con-

E-mail address: laszlo.szabo@ngm.gov.hu

sequence of an already outdated Marxist-Bolshevik concept of the gold standard (Varga, 1978, pp. 139–141, p. 146, pp. 206–207, pp. 299–301, pp. 333–337).[2] Even *Polányi*, the non-Marxist critic of the liberal system blamed the pre-crisis monetary policy of the US for its overly relaxed stance; in his view, in the 1920s the Fed – in the interest of strengthening the pound sterling – kept interest rates lower than justified with regard to internal inflation (Polányi, 1997, p. 37).

There were some among the deflationists who considered deflation and tightening by the central bank instruments of coping with the decline of demand; just as reflationists viewed inflation and stimulation by the central bank: dropping prices increase real income and real wealth, thereby contributing to increasing consumption expenditures (Temin, 1989, p. 9; Garside, 1993, p. 12, p. 19).[3] There were also others who admitted that devaluating/inflationary policy could have partial positive effects, but at the same time, they also thought that due to exchange rate manipulation, the countries employing this policy would lose their credibility which would offset foreign trade and industrial benefits.

The issue *Kindleberger* contemplated also refers back to here: why weren't the positive effects expected of deflation apparent, while negative impacts were? Deflation in the agricultural sector began even before the 1929 crash due to the restoration of production in countries previously at war and other significant sector-specific factors (Kindleberger, 1986, pp. 78–82). In the 1920s, the governments of several countries attempted to shield the agricultural sector from the negative effects of decreasing prices. The financing of reserves accumulated as a result was in many cases possible through loans from developed countries provided to countries specialising in agriculture export; however, these loans begin to dry up by 1929. It is at this point that the asymmetry, referred to by Kindleberger as structural deflation (1986, pp. 91–93), emerges. According to this, the producers of agricultural goods – agricultural countries – did (could) not wait until consumers – importer countries – realised the real income increase caused by the drop in agricultural prices, and successfully fought for their governments to introduce customs duties, quotas and currency devaluation; net agricultural importer countries could not enjoy the positive effects of the improvement of the ratio of exchange as the sectors competing with imports obtained protection for themselves. It is for this reason that only the negative effects of agricultural deflation were apparent, and the positive impacts were not (Kindleberger, 1986, p. 132). If relevant, (expounding on) the concept of structural deflation directs attention to the financial sector; why didn't the loans provided to the agricultural sector/agricultural countries lead to the expansion of lending to other sectors/countries? If this had occurred, the demand deficit caused by structural deflation could have been managed. This means that, ultimately, the basic question in Kindleberger's argument as well becomes: why was the system unable to step outside the bad circle of 'price drop-less credit' (Kindleberger, 1986, p. 140)?

As I have mentioned before, the certain unique feature of deflation was that it was a systematic, global and lasting process, which imbued it with the especially dangerous nature that manifested itself in the Great Depression. The 1920–1922 crisis was also accompanied by deflation in the US; however, it caused far fewer problems than the crisis of 1929.[4] In the years following the war, contemporary experts took notice of the financial disorder and accelerated inflation, while neglecting the basic positive attributes observed compared to the 1929-1933 period. The system of flexible exchange rates – in spite of its imperfections – had the benefit (as opposed to the restored

gold standard) of shortening the crisis (Eichengreen, 1992, p. 100). During the 1920–1922 crisis, major European economies, such as Germany, were in a state of hyperinflation.[5] On a (probably) related note, between 1920–1922 German industrial production doubled, and rose by a further 50 per cent between 1924–1928 (Petzina, 1987, p. 155).[6]

Nevertheless, not everything is clear with regard to deflation. It is unknown whether economic players at the time did indeed distinguish between real and nominal interest rates as economic research assumes. The problem (based on Friedman's analyses) is also related to the seemingly simple, but in reality complex issue of central importance as to whether monetary policy at the time was tightening or expanding. Monetary policy can be characterised by interest and money supply, or with the nominal and real size of these. At given periods during the Great Depression, some of these indicators suggested certain monetary conditions, while others showed different ones; for instance, while the nominal interest rate was high in 1929, real money supply increased. During the crisis, due to significant price drops, horrifying ex-post real interest rates were generated even with relatively low nominal interest rates. It is debatable whether the real interest rates that in retrospect proved to be high were seen/expected in advance and whether this was the factor that hindered investments. If to a certain extent this is the case, then we must attribute a significant role corresponding to this extent to the institutional limit of the nominal interest rate in the crisis – i.e. it cannot be negative – which means the rise of interest rates deteriorated outlooks (Temin, 1976, pp. 163–167). If to a certain extent this is not the case, then to a corresponding extent the mechanisms described by the debt deflation theory enter into force; i.e. the real revaluation of debts and debt inflation significantly deteriorated economic possibilities and led to recession.

The considerable increase in internal indebtedness in the US and the external debt in European countries are factors that could explain why debt deflation at the end of the twenties caused a more serious problem than before. In the US, there was a sharp increase in internal indebtedness between the beginning and the end of the 1920s; in 1928, the volume of public securities amounted to USD 33.6 billion – while GDP was 86.8 billion – and urban real estate mortgages were at 27 billion (Bernanke, 2000, pp. 45-47; Hobsbawm, 1998, p. 95). *Hobsbawm* (1998, p. 99) traces the increase in consumer loans in the 1920s back to wages lagging behind profits; the promise of above-income consumption expansion was spread by financial agencies springing up like mushrooms that radiated unfounded optimism.[7] On the other hand, the upsetting of the balance could also be interpreted in another way; as a result of the stock exchange bubble, investments 'pulled ahead' of consumption, and the other side of over-investment was under-consumption, which led to an increase in inventories and to outlooks becoming uncertain (Kindleberger, 1986, p. 104). There is no agreement as to what extent this indebtedness was the fault of the banking system. *Temin* – debating *Friedman* and *Schwartz* – lists arguments supporting the idea that nothing indicates weak lending and bank investment practice in the 1920s or that this led – independently of the 1929 recession – to bank failures during the crisis. In his view, the series of bank failures was for the most part a *consequence* of the emerging *agricultural crisis* in the US (Temin, 1976, pp. 83–90, pp. 148–149). *Bernanke*, however – in part joining sides with Friedman and the others – emphasises the problematic elements of the lending practices of banks; at the end of the twenties, their wealth was invested in illiquid assets, while they held demand deposits, which from a banking aspect is a reprehensible practice. This is

what led to the exposure of the banks seeing the Fed, established in 1913, as a sort of clearing house, which in turn could have given the impression that the risk of a rush by depositors and bank panics had decreased since the Fed could intervene in such cases. However, in the critical period the Fed was unable to act as a lender of last resort, partly due to its commitment to the gold standard. This means that from a certain aspect, the assumption of Friedman and Schwartz regarding bad banking loans is correct; however, the explanation cannot be comprehended without the global financial framework. One of the problems in bank operation could have been the fact that the curbing (portioning) of commercial credit began sooner than that of broker loans, i. e. the stock market boom was fuelled, while the conditions of realising investments were exacerbated (Kindleberger, 1986, p. 104). We cannot ignore that New Deal measures aimed at fundamentally restructuring the banking system were based on the premise that there were grave problems with the financial mediation system (Cs. Szabó, 1986/1935, pp. 54–57).

The problem of debt inflation had already been treated at the time by *Irving Fisher* and *Kalecki* (Bernanke, 2000, pp. 28–32; Cecchetti, 1997, p. 11; Kalecki, 1990/1931, p. 38). *Keynes*, who incidentally considered the concept of price level problematic, also alluded to the phenomenon, and one of his arguments, besides applying monetary policy tools to crisis management (as opposed to the wage policy tools representing a functional alternative), referred to debt inflation; this undesirable phenomenon could be avoided with the former, but not with the latter (Keynes, 1965, p. 60., p. 293). Analysts today also consider debt deflation to play a key role in the crisis spiral (Kindleberger, 1987, pp. 46–47; Temin, 1989, p. 64; Cecchetti, 1997, p. 16; Bernanke, 2000, p. 87; Landes, 1986, p. 514). In Bernanke's argument, the primary reason for the non-neutrality of money (i. e. the recovery-hindering role of monetary factors during the crisis) is more debt stickiness and less price and wage stickiness. It should be added that the indexation ensuring the preservation of the real value of debts (prohibiting the increase of the real value of debts) did not exist. The prices obviously developed (fell) in a flexible manner. Wages behaved inflexibly depending only on countries and periods, and while employers and employees were able to renegotiate wages – with an eye on common interests, keeping company activity at a manageable level as far as circumstances allowed – i. e. there was a rational interest to resolve inflexibility, there was no such thing in the case of debts.

Besides debt deflation, we can also refer to the phenomenon of tax deflation (which is mentioned less frequently) as a mechanism for the spread of the crisis. The authorities forced the monetisation of economic conditions through the transformation of the taxation system when the global framework shifted towards deflation. Customs duties were typically itemised and not value proportionate; therefore their demand decreasing effect became increasingly apparent during the price drop (Cecchetti, 1997, p. 20). In underdeveloped countries, local authorities in many cases – be it a formally independent country or a colony – reacted to the decrease of taxes related to the population's income by introducing taxes on goods and land as well as poll taxes. The farmers could not afford to withdraw into self-sustenance following the drastic deterioration of market sales opportunities; they were forced to maintain revenues by increasing the sale and export of their products, which in turn led to further price drops on the markets of agricultural goods and raw materials. Global corporations attempted to force the authorities of colonies to lower export taxes, while the authorities made up for lost revenues by intro-

ducing/raising poll taxes (Rothermund, 1996, p. 76, p. 80, p. 120, p. 122, p. 128, p. 131). In the developed world, major agricultural producers were not forced to maximise profits, but to generate revenues due to the inflexibility of monetised obligations – taxes and previously established ground rent.[8]

The deflation effects most probably spread through both the real economy and monetary policy. For my part, I have no desire to decide the debate between Temin and Bernanke. According to Bernanke's analyses performed using newer econometric methods, money and the monetary sector played more than just passive roles.[9] The banking crisis and the bank panics were not simply reflections of the economic crisis, but played active roles in generating deflation, just as deviating from the gold standard was not entirely endogenous with respect to income processes (Bernanke, 2000, pp. 15–17, p. 26). Due to increased caution in banking lending policy and the drop of the loan multiplier, certain economic players found it increasingly difficult to access credit. The tightening of banks' lending policy and the decrease of the money multiplier in the US can only be observed following the banking failures of November 1930, which means that these played no role in the earlier phase of the crisis – despite the drop in production which was already in double-digits at the time. In October 1931, the net loan volume relative to personal income fell by 31 per cent. There was pressure on farms, households and small businesses to pay back their debts. Traditional mortgage lenders and insurers left the market, and by 1934 mortgage loan volume shrank to only 3 per cent of its previous size. The banks did not raise loan interest rates; instead they started to portion loans. They rejected certain clients who in calmer times qualified as good creditors, and scrambled to serve highly rated investors, who, however, did not expand their activities in a proportionate manner.[10]

In contrast, Temin saw no proof that during the US crisis the liquidity squeeze represented a significant negative factor. Economic players had financial wealth which they could have liquidated if they needed funds. The drop in loan volume is due to the fact that the money demand of economic players had decreased; as a result of dropping sales and decreasing inventories, companies required less and less credit. The population's savings flow increased throughout the 1929-1931 period due to the drop in commitments which Temin interprets as a decrease of money demand (Temin, 1976, pp. 127–133).

Even though Temin did show willingness to admit that the risk premium rose on the bond market, the increase of this particular loan expense was not apparent in the case of small businesses and was not above average (Temin, 1976, p. 133; Temin, 1989, pp. 52–54). If there would have been an undetectable effort by the banks to curb lending by increasing interest rates, then it is a mystery why recession was smaller and not greater in sectors dominated by family and small businesses that were – according to Bernanke – hit harder by the credit crisis than sectors dominated by large corporations (Temin, 1989, pp. 50–51, p. 54). Bernanke's rhetoric also indicates that he cannot provide a precise response to this question either; as he puts it, the debt crisis is a "much less scripted topic" than bank panics and it would be "especially valuable" to have an analysis that would uncover the effects of the financial situation of companies on their production and employment decisions (Bernanke, 2000, p. 97).

Temin's arguments discussing the significance of the banking crisis in sceptical terms rely mostly on US data, just like Friedman's analysis underscoring the severity of the banking crisis. The latest panel research, providing a foundation of international comparison, relying on a wider database conducted by Bernanke – who is also responsible for the

further development of monetary arguments – show with regard to several important monetary and other features (for example, whether the given country was controlled by the gold standard) that the longer a banking crisis lasted, the greater the recession was. According to Bernanke's calculations, the one year protraction of the banking crisis entailed a 16 per cent drop in production.[11] Even Bernanke admits that the drop in the deposit/cash ratio and the bank panic (in some countries the former manifested itself without the latter) were endogenous responses to deflation and the operation of the gold standard system. However, country-specific institutional factors also played a significant role, in particular the structure of the banking system and the ratio of foreign depositors. In many countries, the problems of banks surfaced well before the drop in international prices (Kindleberger, 1986, p. 145).

FORMATION OF A NEW FRAMEWORK

As far as recovery from the crisis is concerned, we cannot see clearly, and there are still debates in progress among those who interpret the crisis as the mismanagement of the international financial system. There, however, seems to be an agreement that the most expedient solution would have been to transform the international financial framework with the joint consent of the states, as part of which the deflation bias of the framework would have been eliminated and the application of stimulating economic policy would have been made possible on a global level. There is, however, a great difference between whether the actual measures taken – leading to the formation of the global framework – have actually helped recovery or not.

According to *Kindleberger* (1986, p. 191), investments in the US in 1932 spontaneously reached the minimum level from where growth was the only direction possible. The political, economic policy and attitudinal changes, especially those that can be linked to the new American administration taking office, or the isolationist change in the economic policy and mainstream economics in Great Britain – the reduction of the country's international commitments and the one-sided solution of internal problems – essentially held back international economic relations for years. If there were positive changes in the international framework, these only occurred at a later stage. When the world powers – the US, Great Britain and France – committed to the stabilisation of the international financial framework to a certain extent in a deliberated manner at economic conferences (trilateral agreement), and when they started to do away with the protectionist measures that had been taken during the crisis. Kindleberger demonstrates that not only did a cooperative solution exist for all involved, but part of the contemporary elite was also aware of it, and as a result, several different concepts consisting of measures to stimulate lending and international projects have also been drafted. In his case the most important point was that – although this also indicates the responsibility of the other great powers – Roosevelt's administration was largely unprepared. This is in contrast to the Hoover administration which almost embraced the hegemonic role thrust upon it and ultimately steered the USA towards isolationism in a rather narrow minded and amateurish manner for years, which, in terms of global evolution, was overall a negative turn of events.

Temin and *Eichengreen* saw the situation as significantly more complex, as did *Károly Polányi* and *László Cs. Szabó* at the time. Both Temin (1989, p. 33) and Eichengreen admit that the theoretical possibility of a mutually beneficial, cooperative global stimulus did exist and that the politicians of the USA and the Fed did not cope with the situation they were cast into. They think, however, that the policies

pursued led to the development of a framework that is better than the old one – albeit in a chaotic manner – and did not hinder it. According to Eichengreen (1992, pp. 153, 322) one should not disregard the fact standing in the way of an agreement that the empirically undecidable theoretical concepts used to assess the situation were at odds, especially with regard to the issues of exchange rate policy and protectionism. The unpleasant experience of the hyperinflation of the 20's in certain European countries – especially in Germany – had absurdly continued to exist under the conditions of extreme deflation, which made it particularly difficult for them to recognise the problematic nature of deflation.[12] The systematic significance of capital movements and the importance of cooperation between central banks – which made it necessary for international financial circles to give up faith in an automatic corrective adjustment mechanism – have only started to become topics worthy of theory (Eichengreen, 1992, pp. 33–42).

In the opinion of Temin (1989, pp. 93, 102), during the Great Depression the devaluation of the sterling and the dollar was a positive symbolic sign of a new political power, the rise and coming to power of *Hitler*, severing its links to the past – including the earlier economic policies – that was able to convince the public of its ability to completely uproot and transform the existing framework. According to Kindleberger (1986, pp. 90, 227), however, the fact that the sterling was taken off the gold standard and devalued only strengthened the damaging deflation spiral (which Eichengreen contests); although the devaluation of the dollar did not have the same deflationary effect, nor did it have a positive result, since the boom that followed could be traced back to the "myriad of changes inherent in the expectations" and the complete stalling of gross investments.[13] According to Eichengreen, the suspension of convertibility to gold was only a necessary precondition of the boom, which can only occur when the gold standard is fully cast aside both as an ethos and as an orthodox financial issue. Moreover, for certain representatives of the orthodox, anti-inflationary budgetary and monetary policy, not only did the exiting from the gold standard not bring a new way of thinking into the picture, but it added a new negative feature, which needed to be counteracted by adhering even more strictly to the previous principles in order to regain credibility.[14] Just as the unique economic policy decision of a specific country, deflation or giving up the gold standard cannot in general be considered of symbolic significance. Just as it could have helped the transformation of the framework and the expectations indirectly, in a manner that is not yet apparent in terms of economic theory, which may go unappreciated by the critical Kindleberger, when he refers to the "myriad of changes inherent in the expectations". *Botos* has provided a somewhat similar interpretation (1987, p. 93), according to whom devaluation makes depression worse at the outset, but also compels others, as an indirect effect, to wind up the deflation framework and take steps towards expansion.

The fact that it was Great Britain, the protector and guardian of the gold standard that went down this path is what made the devaluation of the sterling in 1931 a transformative, symbolic act – if one can speak of something like that at all. To its opponents, the British decision held the prospect of international anarchy; they thought that run-away exchange rates and the economic crisis would go hand in hand, but they thought that cause would be the former measure and not the latter. They thought that the country doing the devaluation would be thrust into a more advantageous situation at the expense of its international trade partners, pushing them down in a zero-sum game, breaking the rules of cooperation. Of the contemporaries, Kalecki, an advocate of

stimulus, termed the British devaluation a tool of deflation policy, the only effect of which is to improve the export capacity of Britain at the expense of the other countries.[15] According to *Varga*, who is a Marxist, the devaluation – the "foreign currency and interest rate manipulation" based on "vulgar and shallow" Keynesian theory – is a means of modifying the distribution of income to favour the bourgeoisie and of intensifying the exploitation of the proletariat, which can only provide temporary advantages to the devaluing country (Varga, 1978, pp. 169–170, p. 255, p. 306, p. 345). British industrialists at the time saw devaluation only as a tool analogous to wage decrease for improving their competitiveness (Kalecki, 1990/1931, pp. 39–40). The reason why the British decision-makers hesitated for quite a while in 1931 was because they were afraid that others would follow them down the path of devaluation, thus preventing them from realising the benefits they hoped to achieve (Booth, 1993, p. 39). A few years earlier in some of the countries of the British Commonwealth such as Australia and New-Zealand, devaluation was the means whereby mainly export-oriented agricultural losses were to be spread more evenly across society (Endres – Jackson, 1993, pp. 152–153).[16] As a result of the gold escape that started after the Brits exited the gold standard, in countries such as Egypt or India creditors began asking debtors to repay them in gold, which meant the decrease of the money supply (Rothermund, 1996, p. 79, p. 91). In India's case, the gold of creditors thus acquired flowed to London, strengthening the monetary stimulation of the sterling block. Initially, the decline of the import of the devaluating Brits contributed to the recovery already underway in the UK. All this reinforced the conviction of gold proponents that the sterling devaluation was no more than protectionist policy, aimed at drowning the others (Eichengreen, 1992, pp. 289–292).

In other words, the sterling devaluation did have deflationary consequences. It was not without reason that on a purely theoretical basis Kindleberger thought that the foreign currency devaluations which started at the peripheries were factors strengthening deflation, and the devaluation of the sterling caused a further drop in raw material prices (Kindleberger, 1986, p. 293). The main question, however, is whether these were the exclusive or decisive factors.

Temin, Eichengreen and Bernanke were those who were recently of the opinion that the most important factor in the pound devaluation launched by the Brits was letting the stimulating monetary policy loose. This beneficial effect was to some extent offset by the negative protectionist impact, which, however, was unable to neutralise it completely (Temin, 1989, p. 32; Eichengreen, 1992, p. 22). According to Temin (1989, p. 74), after the Brit devaluation – in contrast to the opinions of contemporaries and later analysts such as Kindleberger (1986, p. 176) – the global drop in prices of raw materials did not accelerate, and the international price increase began when the US exited the gold standard. The nature, global applicability and success of the new framework were hardly felt for one to one and a half years after the devaluation of the sterling. Half a year was needed to convince those worried in Great Britain about the perceived inflation dangers of inflation that their fears were unfounded, and building on this, for the BoE to set off on the road to reducing interest rates and easing monetary policy (Eichengreen, 1992, p. 303). The difference between the depression of those insisting on the gold standard and the upswing of those exiting it was already apparent in 1934 (Eichengreen, 1992, p. 28).

The essence of this new framework was not devaluation as a unique monetary policy measure. The defining attributes of the new framework were the following efforts:

regulation of public property or the command chain, government intervention in the wage agreement, and sharing "social dividend" with all.[17] Devaluation became a lasting, positive event as part of a stabilising framework establishing new forms of international cooperation – and as an available economic policy option. This indicates that after the final collapse of the gold standard, by 1937, at the end of the series of successive devaluations, the exchange rates of the main currencies climbed back to the levels recorded at the beginning of 1931 (Eichengreen, 1992, p. 362, p. 393).

The individual economic measures gained meaning – prefixes – embedded in a socio-political context and influenced expectations of the utmost importance.[18] This is why the narratives of Kindleberger and Eichengreen on Roosevelt's policies differ fundamentally. The former demands the very best imaginable for the outsider of the president and politics in general. The latter, however, shows the uncertainty of fumbling, where politics is tossed around in the swarm of everyday information impulses stripped of clear expert guidance, jerked around by interest groups raising contradicting proposals even within their own parties – at times articulated on an atavistic theoretical basis (see silver movement) – revolving among the demands international partners (of the debt release claims of the Brits and the French) without any regard for the internal situation of the US. He also tries to read from the – in themselves inconsistent – steps taken by economic players what state measures could return the confidence for the future, since developments showed that expectations are capable of neutralising the positive, textbook/recipe-like effect of unique measures.[19]

The change of framework, even if it did lead to a definite result in the end, was probably based on several unclear signs as opposed to a single clear sign (in contrast with what Temin stated about devaluation and how the Nazis gained power); the change was not a clear break with a single direction, but gradual with changing directions.[20] The economists and decision makers did not see or only partially saw – though they might have thought otherwise – how the proposed and implemented measures contributed to the establishment of a global, expansive framework and which aspects and elements of these measures were neutral to or in conflict with this framework. Under circumstances of democracy, politics in Great Britain did not strive to achieve a maximum of total economy (that was hardly possible in the given historical situation), but aimed for a level widely deemed sufficient, and it did succeed in this respect. The core decision-makers of the parties, taking advantage of the fact that newer economic doctrines had uniform interpretations, were able to take the wind out of the sail of those calling for more radical changes, and at the same time were also able to manage threatening social conflicts (Booth, 1993).

In my opinion, of the contemporaries it was Károly Polányi who recognised the epochal significance of giving up the gold standard. In his opinion, exiting the gold standard saved the US and Great Britain from having to save the gold standard through interventionism that would have eliminated liberal and democratic institutions (Polányi, 1997, p. 289, p. 295). The supporters of deflation argued for strong government and free economy, but in reality, they took the first steps in the direction of the right to a state of emergency and regulated prices and wages. Over the course of this, they weakened democratic institutions, thus paving the way for fascism, which was less self-deluding, more honest and realistic (acknowledging the existence of power and force in society) than they were. It is typical of the chaos of theory and rhetoric that *Brüning* attempted to substantiate his very own decidedly interventionist policy – which he believed served the

protection of the gold standard – and reject reflationist proposals by saying that direct intervention in the interest of managing capitalism would demolish the foundations of future economic stability (Garside, 1993, pp. 17–18; James, 1993, p. 72).[21] A New Deal – in the words of László Cs. Szabó (1985, pp. 78–79), who was rather critical of several measures and considered the entire experiment rather confusing according to his own view of economics – was about the "fatal issue" of whether political democracy could survive at the level of contemporary industrial organization.

There was also talk of making the commitment of politics that can be influenced by economic players against global deflation believable and enduring, in which case deflation was indentified with "the difficult to approach central bank" (Cs. Szabó, 1985/1935). In addition, in a way that would ensure that the recognition and acceptance of the embeddedness of monetary policy in a democratic environment in the worldview of economic agents. Even if, under the given circumstances, this was possible through the application of measures (or in addition to such measures) that undermined – at least temporarily – international cooperation. As long as this was not the case, the various stimulating measures were unable to change the course of things. Moreover, in certain cases they provided the opposing camp a frame of reference, who were thus able to argue for the unusability and ineffectiveness of the new paradigm, as shown by the events of 1932. This was the year when legislation in the US began to steer the Fed towards reflation by amending the relevant regulations. Specifically, they were required to perform open-market operations, as a result of which the Fed purchased large quantities of bonds – for one billion USD, equivalent to more than 1 per cent of the GDP. As a result, wholesale prices rose; industrial growth, however, failed to pick up, which the opposing camp, gold supporters saw as the confirmation of their argument.[22] According to Eichengreen, the failure of expected beneficial results to materialise was in part due to the fact that those controlling industry did not believe, mainly due to political uncertainty that the launched stimulus could last. In July 1932 the presidential election campaign commenced and the pressure exercised by Congress on the Fed let up. Investors and producers saw that legislation's attempt at stimulus – for the moment at least – could not be institutionalised (Eichengreen, 1992, p. 315). Believable and enduring political commitment in the US was brought about by Roosevelt, and the, of course, inconsistent and confusing direction of the Democratic Congress, which made monetary policy serve the democratic political system.

SUMMARY

One should only try to understand the Great Depression (although this only used to be a side-thought in the economic thinking that followed the Second World War) from a global standpoint, by recognising the characteristics and biases of the global, political, economic, monetary frameworks of the time. It cannot be stated that the research conducted of the era could fully explore the contemporary "melt-down" of the global economy, the unexpected severity and length of the crisis and all of its important details. The completeness of this explanation is upset by anomalies and the identified deficiencies in our knowledge. The explanation and comprehension cannot refer to transparent and simple economic mechanisms. On the one hand, in retrospect it seems relatively simple to identify the system errors in the mechanism of the

financial system prone to deflation; on the other hand, however, it is difficult to understand why this simple recognition did not lead to the implementation of the changes required for the solution. The economic agents and the economic policies continually oriented and disoriented each other (and each other's expectations); they reflected on each other, but, as a new framework was being created, they did so in a rather unpredictable manner (which itself was dependent upon this interaction). The theories and convictions influencing this proved to be inappropriate either due to their lateness or their earliness. Even if it is possible to talk about crisis recovery 'tools', the usability of these tools depends on their place in historical context and the global complex. These tools are not 'purely" economic, and neither is the origin of the crisis, as 'pure' economy is just a theoretical construct/fiction and not historical reality. In my opinion, the most emphatic part of the lesson lies in recognising the political, social embeddedness of financial frameworks, and recognising the dependence on the trust-based capital that follows from that embeddedness, and not in exploring and re-applying monetary and fiscal techniques.

Notes

[1] Eichengreen, 1992, p. 301

[2] The contradictions of Varga's argument show that the problem was not just with the economic views widespread in official circles, but also with those of political movements that on the surface were considered enemies of the system. In time, by 1936, Jenő Varga reached the conclusion that inflation/devaluation are also alternatives of deflation in establishing a 'normal' relationship between value and price, with the benefit over deflation of the middle class not having to face the resistance of the working class.

[3] We can also place this argument into the IS-LM model (Mankiw, 1999, p. 316), which in other words means that this particular textbook model provides no help in the debate on the stabilising vs. destabilising role of deflation.

[4] In the 1920–1922 period, Federal Reserve lending increased substantially, which could have offset the negative impact of deflation (Cecchetti, 1997, p. 12, p. 23).

[5] Temin, 1989, pp. 60–62

[6] In Sargent's paper (2005, p. 108), the dynamic increase achieved in the period of hyperinflation appears only as 'over-investment' into real capital goods.

[7] In contrast with Jenő Varga, Hobsbawm discusses the phenomenon rather as an American specificity of the period than a general contradiction of capitalism. To some extent, Botos is of the same opinion (1987, p. 49, p. 64, pp. 98–101).

[8] Varga, 1978, pp. 230–232

[9] Temin does not find Bernanke's regressions conducive to making a choice between competing hypotheses; regressions that prove the 'close relationship' of the proxies of bank failures and risks with the development of industrial production (Temin, 1989, p. 52).

[10] (Bernanke, 2000, pp. 52–54) it is at this point that it becomes apparent that consistency is not always ensured in the narratives of certain authors; for instance, on the one hand Bernanke states that banks provided loans to debtors with good credit histories even in difficult times. On the other hand, however – without resolving this conflict – he informs us that 45 per cent of highly rated corporate debtors reported difficulties (i. m. p. 64).

[11] Referencing Kindleberger, Borchardt (1987, p. 33) assigns a greater role to the banking crisis; the impact of the crisis could have been reduced to half had they been able to avoid the collapse of the international credit system in 1931–1932.

[12] See the personal confession of Hayek (1995, p. 129), who by the way later went on to revise his own views from the 1930s on the matter.

[13] James (1993, p. 81) was also of the opinion that there were "spontaneous cyclical forces" behind the boom that started at the time of Nazi rule.

[14] Eichengreen, 1992, p. 21, pp. 288–289, p. 344; on the same subject also see Kindleberger, 1986, p. 226. The Fed abstained from taking advantage of the boom opportunity for an extremely long time (Eichengreen, 1992, pp. 344–346). The BoE, however, started the stimulus half a year after the devaluation. The fact that the boom followed in spite of all this confirms the thesis of interpreting the processes in terms of a change of framework and not simply as a monetary policy phenomenon, and weakens the case for a one-sided monetarist approach (Bernanke, 2000, p. 154; Eichengreen, 1992, pp. 342–345).

[15] Later, however – accepting in part Keynes' argument of the early 1930s – he felt that devaluation could assist recovery as it helps "to lure out" the gold of creditors, especially gold standard supporting countries by the fact that the export of debtors exiting the gold standard aimed at creditor countries could pick up, their balance of payments could improve and gold reserves could increase. Kalecki's first opinion was largely influenced by the fact that in 1932 the Brits did not use devaluation for monetary easing (Kalecki, 1990/1932a, p. 47; 1932b. p. 51).

[16] In connection with devaluation, Ciepielewski et al. and Bernstein speak of a competitiveness effect enforced at the expense of others, and qualify deviating from the gold standard as protectionism (Ciepielewski, 1974, p. 306, p. 312) (1987, p. 117).

[17] Temin, 1989, p. 107

[18] Just as the hyperinflation of the 1920s was not ended with unique restrictive measures (Sargent, 2005, p. 114), neither was global deflation.

[19] After March 1933 (the restart of the banking crisis), the economy exhibited signs of dynamic recovery for five months, but in the last third of the year, it began showing signs of fatigue. Playing a role in this, beyond the passivity of the monetary authority, was the fact that due to expectations of devaluation, exporters held out with sales while increasing imports. Only after the dollar exchange rate was stabilised in January 1934 and exporters could not count on further devaluation, did the speculators sell their stocks and close their positions against the dollar (Eichengreen, 1992, pp. 344–345).

[20] As James puts it, the model of a Germany detached from the world economy through the suspension of the debt service, overvalued currency and the regulation of foreign trade is not a creation of Nazi ideology, but the innovation of the Brüning government, and rejects the assumption that Hitler did indeed do what he promised in the economy as not sufficiently substantiated (James, 1993, p. 88).

[21] In this, he found an occasional ally in the Communists, who rejected certain reflationist proposals of the Social Democrats. Jenő Varga, for instance, declared the recommendation of the social democrats regarding wage increase nonsensical. Varga expressly admits (1978, p. 75) that in this assessment capitalists and Marxists are on the same platform.

[22] In contrast, Friedman (Friedman, 1998, p. 77) says that just as the favourable effects were starting to show, the Fed terminated its programme; and even according to Kindleberger (1986, p. 192) these signs were already apparent, for instance, industrial production started to grow in July.

LITERATURE

BERNANKE, B. (2000): Essays on the Great Depression, *Princeton University Press*

BERNSTEIN, M. A. (1987): Gazdasági instabilitás az Egyesült Államokban az 1930-as és az 1970-es években (Economic Instability in the United States in the 1930s and the 1970s), In: Válság – recesszió – társadalom (Crisis – Recession – Society), (ed: Iván T. Berend and Knut Borchardt) KJK

BOOTH, A. (1993): The British reaction to the economic crisis, In: Garside (ed): Capitalism in crisis: international responses to the Great Depression, Pinter Publishers

BORCHARDT, K. (1987): Az 1930-as évek válságának következményei és mai tanulságai (The consequences and modern conclusions of the 1930 crisis), In: Válság – recesszió – társadalom (Crisis – Recession – Society), (ed: Iván T. Berend and Knut Borchardt) KJK

BOTOS, K. (1986): 1929/33 vs. 1979/83, In: The impact of the depression of the 1930's and its relevance for the contemporary world (ed: Iván T. Berend and Knut Borchardt), Karl Marx University, Academy Research Center of East-Central Europe

BOTOS, K. (1987): Világméretű pénzügyi egyensúlyhiány. (*Global Financial Imbalance*). KJK

CECCHETTI, ST. G. (1997): Understanding the Great Depression: Lessons for Current Policy. *NBER Wp 6015*

CIEPIELEWSKI, J.– KOSTROWICKA, I.– LANDAU, ZB. – TOMASZEWSKI, J. (1974): A világ gazdaságtörténete a XIX. és a XX. században (*World Economic History in the 19th and 20th Centuries*). Kossuth Kiadó

CS. SZABÓ, L. (1985/1935): *Franklin Delano Roosevelt.* Magvető (Seedsman)

EICHENGREEN, B. (1992): Golden fetters: the gold standard and the Great Depression, *Oxford University Press*

ENDRES, A-M. – JACKSON K. E. (1993): Policy responses to the crisis: Australasia in the 1930s, In: Garside (ed): Capitalism in crisis: international responses to the Great Depression, Pinter Publishers

FRIEDMAN, M. – FRIEDMAN, R. (1998): *Választhatsz szabadon (Free to Choose).* Akadémia – MET Publishing Corp

GARSIDE, W. R. (1993): The search for stability: economic radicalism and financial conservatism in 1930s Europe, In: Garside (ed): Capitalism in crisis: international responses to the Great Depression, Pinter Publishers

VON HAYEK, A. (1995): *Piac és szabadság* (*Markets and Freedom*). KJK

HOBSBAWM, E. J. (1998): *A szélsőségek kora (The Age of Extremes).* Pannonica

JAMES, H. (1993): Innovation and conservatism in economic recovery: the alleged 'Nazi recovery' of the 1930, In: Garside (ed): Capitalism in crisis: international responses to the Great Depression, Pinter Publishers

KALECKI, M. (1990/1931): The World Financial Crisis, In: Collected works, Volume 1. Capitalism, cycles, and full employment, Oxford University Press

KALECKI, M. (1990/1932a): Mr. Keynes' predictions, In: Collected works, Volume 1. Capitalism, cycles, and full employment, Oxford University Press

KALECKI, M. (1990/1932b): Is a 'Capitalist' Overcoming of the Crisis Possible?, In: Collected works, Volume 1. Capitalism, cycles, and full employment, Oxford University Press

KEYNES, J. M. (1965): A foglalkoztatás, a kamat és a pénz általános elmélete *(The General Theory of Employment, Interest and Money)*. KJK

KINDLEBERGER, CH. P. (1986): The world in depression 1929–1939, *University of California Press*

KINDLEBERGER, CH. P. (1987): A nemzetközi tőkemozgások és a devizapiacok válsága – az 1930-as évek és az 1980-as évek (The International Movement of Capital and the Foreign Exchange Crisis – the 1930s and the 1980s), In: Válság – recesszió – társadalom (Crisis – Recession – Society), (ed: Iván T. Berend and Knut Borchardt) KJK

LANDES, D. S. (1986): *Az elszabadult Prométheusz* (*T*he Unbound Prometheus). Gondolat

MANKIW, GR. (1999): *Makroökonómia (Macroeconomics)*. Osiris Kiadó

OHNSORGE-SZABÓ, L. (2010): The Great Depression – Retro, Part 1, *Pénzügyi Szemle (Public Finance Quarterly)*. Issue 4, pp. 750–764

PETZINA, D. (1987): Válságok és válságstratégiák – a két háború közötti időszak német tapasztalati és a jelen (Crises and Crisis Strategies – the Interwar Period, the German Experience and the Present), In: Válság – recesszió – társadalom (Crisis – Recession – Society), (ed: Iván T. Berend and Knut Borchardt) KJK

POLÁNYI, K. (1997): *A nagy átalakulás* (*The Great Transformation*). Issued by Gábor Mészáros

ROTHERMUND, D. (1996): *The Global impact of the Great Depression*, 1929–1939. Routledge

SARGENT, TH. J. (2005): *Infláció és racionális várakozások (Rational Expectations and Inflation)*. Nemzeti Tankönyvkiadó

TEMIN, P. (1976): *Did monetary forces cause the Great Depression?* Norton

TEMIN, P. (1989): *Lessons from the Great Depression.* MIT

VARGA, J. (1978): *A Nagy Válság* (*The Great Depression*). Kossuth Kiadó