Rothbard's *America's Great Depression*, Chapter 4, Part 1

The Inflationary Factors

- There are too many varying causal factors to use statistics to "test" theory
  - See Mises, Hayek, Robbins for more on theory
  - We can observe credit expansion, but we cannot say what rates would have been without it
- 1920s: competing increasing productivity vs. monetary inflation
- Monetary inflation stabilized prices **but**
  - Reduced the spread of improved standard of living
  - generated the boom and made the bust inevitable
- This book is not an economic history
  - We won't be tracing minutiae and causes around the data
  - We will focus on the culprit: the government

The Definition of the Money Supply

- Money v. money-substitutes = specie v. bank deposits (+other stuff)
  - money-substitutes may suddenly lose their moneyness e.g. by a bank failure, but until they do, they count!
  - See Lin Lin's paper "Are Time Deposits Money?" and McKinley's "The Federal Home Loan Bank System and the Control of Credit" (and McKinley's "Reply")
- Time Deposits have restrictions but are almost never enforced
  - This is still pretty true
  - See French's "The Significance of Time Deposits..."
  - Note that banks paid interest on demand deposits until 1933 (it was outlawed)
  - Time deposits were held at commercial and mutual savings banks, but it's largely a distinction without a difference
  - Anything readily convertible to cash on demand should count
  - Controversially, the *surrender value* of life insurance policies might be worth counting, because it is readily convertible and had a big change in this timeframe
  - See Lin, "Professor Graham on..." and Graham, "One Hundred Percent..."
  - See Selden in Friedman, "Studies in the Quantity Theory..."
  - See McKinley in Prochnow, "The Federal Reserve System"

Inflation of the Money Supply, 1921-1929

- July '21 – July '29
- Is Table 1 biased by its choice of start and end points?
- 7.7% per year!
- No increase in actual currency—all in money-substitutes, products of credit expansion!
- Consumer credit negligible (<$1 billion increase)
- Only a little increase of gold reserves, leverage up by ~60%
- See *Banking and Monetary Statistics*, Phelps, "The Role of the Sales Finance..."

Generating the Inflation I: Reserve Requirements

- The most important element of the money supply is commercial bank credit
- Where did the extra bank credit come from? Three possibilities:
  1. Reduction in reserve requirements
  2. Increase in reserves
  3. Decrease in reserves above requirements
- No data pre-1929 for excess reserves, but generally believed to be low and unchanged
  - See *Banking and Monetary Statistics*
  - Not the culprit
- See Shelby, "Some Implications..."

- Reserve requirements did not change
  - They varied by bank type, though, so maybe deposits moved from high-requirement banks to low ones?
  - No, it's not that (Table 3)
  - See Currie, "The Supply and Control..."
  - They also varied between member and non-member banks
  - No shift there, either—not the culprit
  - They *also* varied between time and demand deposits
  - This *did* change—here's a big chunk of our culprit!
  - See Anderson, *Economics and the Public Welfare*

Generating the Inflation II: Total Reserves

- Increase in reserves v. Increase in reserve ratio?
  - Table 6: Mostly reserves from 1921-5, both from 1925-9
- Ten factors of increase/decrease, and whether they are controlled by the government

1. Monetary Gold Stock—Increase, not controlled
2. Fed Assets Purchased—Increase, controlled. Except when the seller gets cash (rare)
3. Bills Discounted by the Fed—Discounting is a controlled increase, repayment is an uncontrolled decrease
4. Other Fed Credit—Increase, controlled, but negligible
5. Money Circulating Outside Banks—Uncontrolled, could go either way
6. Treasury Currency Outstanding—Increase, controlled. Tends to flow to commercial banks.
7. Treasury Cash Holdings—Decrease, controlled
8. Treasury Deposits at Fed—Decrease, controlled
9. Non-Member Bank Deposits at Fed—Decrease, uncontrolled
10. Unexpended Capital Funds of Fed—Decrease, controlled, but negligible

- See page 107 in the 5th edition for a summary
- Most Increase factors are controlled, decrease factors it's about half and half
- Depends on what *actually* increased and decreased
- In short: The uncontrolled factors were deflationary, but the controlled factors were highly inflationary
  - Therefore, the inflation is the fault of the Fed and gov't
  - Biggest controlled factors were Bills Bought, Gov't Securities, New Discounts
  - 12 subperiods suggested by Rothbard
  - Breakdown of these periods on p. 111-116 is long but not complicated
    - Inflation finally ceases in subperiod XII
    - Time deposits no longer come "to the rescue" of other diminishing inflationary factors
    - Market crash in October 1929

References:

THE BOOK
https://mises.org/library/book/americas-great-depression

Human Action, Mises
https://mises.org/library/book/human-action

Monetary Theory and the Trade Cycle, Hayek
https://mises.org/library/book/monetary-theory-and-trade-cycle

The Great Depression, Robbins

https://mises.org/library/book/great-depression

Are Time Deposits Money?, Lin
https://www.jstor.org/stable/1803818

The Federal Home Loan Bank System and the Control of Credit, McKinley
https://www.jstor.org/stable/2976850

Comment Reply, McKinley
https://www.jstor.org/stable/2975933

The Significance of Time Deposits in the Expansion of Bank Credit, 1922-28, French
https://www.journals.uchicago.edu/doi/abs/10.1086/254284?journalCode=jpe

Prof. Graham on Reserve Money and the 100 Per Cent Proposal, Lin
https://www.jstor.org/stable/1803824

100 Per Cent Reserves: Comment, Graham
https://www.jstor.org/stable/367

Studies in the Quantity Theory of Money, Friedman
https://archive.org/details/studiesinquantit0000frie/page/n7/mode/2up

The Federal Reserve System, Prochnow
https://archive.org/details/in.ernet.dli.2015.190477/page/n1/mode/2up

The Role of the Sales Finance Companies in the American Economy, Phelps
https://archive.org/details/roleofsalesfinan0000clyd

Some Implications of the Growth of Financial Intermediaries, Shelby
https://www.jstor.org/stable/2975931

Banking and Monetary Statistics 1914-1941, Federal Reserve System
https://fraser.stlouisfed.org/files/docs/publications/bms/1914-1941/BMS14-41_complete.pdf

The Supply and Control of Money in the United States, Currie
https://academic.oup.com/psq/article-abstract/50/3/432/7242097?redirectedFrom=fulltext

Economics and the Public Welfare, Anderson
https://archive.org/details/economicspublicw0000ande/page/n3/mode/2up