How banking affected the depression

Literature, Russian Literature

Banking and the Great Depression The Great Depression can be considered to be the most economically significant event to occur in the financial history of the world. It affected the entire world as a whole though it began in the United States and led to the suffering of millions as they endured the repercussions that followed its occurrence. A number of economic experts and financial analysts have studied this crucial time to find out the cause that led to the economic downfall in a bid to prevent something similar from occurring again, a number of theories have occurred from these studies, but two main ones that will be discussed in this paper are the Monetarist and the Keynesian theories which have garnered a lot of attention over the years (Mishkin, 2010). The Monetarist theory argues that the reason behind the Great Depression and why it lasted so long was the making of poor policies by the Federal Reserve coupled by the poor state of the banking system that was being experienced at the time. This resulted in what is termed as monetary contraction, and the money supply in the country decreased more substantially than in a normal recession. The theory argues that should not it be for this abnormal contraction, the Great Depression would have turned out to be just another recession that the country would have been able to pull itself out of (Mishkin, 2010). The Monetarist theory also argues that the Federal Reserve did nothing as large public banks began to falter and fail in their business leading to the emergence of a panic among the local banks leading to a domino effect as the smaller banks began to collapse as well. The theorists argue that had the Federal Reserve have done something to prevent the collapse of these major banks, such as issuing of emergency lending to a few major branches or purchasing the government bonds that

were in the open market, the banks would not have collapsed as they did (Kennedy, 1999). However, it can be argued that this was not entirely the Federal Reserve's fault as they were prevented from doing so by the Federal Reserve Act which limited the amount of money they were able to lend out. The Act required a minimum gold backing of 40% of the bank notes that were issued, a level that had already nearly been reached by the 1920s (Atack, & Passell, 1994). As a result, there was significantly less money supply making it hard for businesses to continue their operations with the help of loans that were scarce and extremely difficult to come across. The Keynesian theory argued that the main reason behind the Great Depression was the emergence of decreased expenditures on aggregate within the economy at that point of time, which led to a decrease in income levels as well as employment. According to this theory, in order to sustain the economy during such a situation the government had a responsibility to step in where the private sector would not get in a down trodden economy to be able to sustain employment as well as production levels by running deficits when needed. This could be done through the following measures: decreasing the tax rates to ease the financial burden for individuals and businesses; and increasing the amount of government expenditure to ensure that important sectors in businesses do not have to close up. This was done by President Roosevelt via the introduction of financial assistance such as farm subsidies, but, according to the Keynesian theorists, the government did not spend enough to pursue the claimed goals until the start of the World War II (Mishkin, 2010). However, it can be argued that government intervention was not the main factor to have caused the depression as the

government was experiencing the same financial difficulties as private businesses and individuals. This means that intervention would have been difficult because measures, such as cutting taxes, for example, could not be entirely sufficient as the government still needed the money to run their affairs, thus, subsidies could not be given in significant amounts as there was no money in the treasury’s coffers for such an extreme spending. It can be noted that both theories had similarities with the major one. They both blamed government inaction insisting it had caused the depression. But the accusations of the representatives of two theories contained some noted differences. The monetarists, for instance, blamed the policies that were implemented during that time, while the Keynesian theory concentrated on the economic actions that were taken to rescue the financial status of the country (Atack, & Passell, 1994). Upon close examination of the two theories, it can be argued that the Monetarist theory made more sense as, according to it, the financial institutions, such as banks, are economic backbone of the country. A successful banking system leads to a stable financial environment as economic assistance, such as loans, is easily accessible while government help in the form of subsidies can also last for long period of time. This can be seen in the current financial crisis being experienced by the Euro zone at the moment whereby the instability of the banks has worsened the situation making it difficult for the governments concerned to step in with monetary assistance that will create a credible change. References Atack, J., & Passell, P. (1994). A new economic view of American history. New York: W. W. Norton and Co. Kennedy. D. M. (1999). Freedom from fear, the American people in depression and war 1929 – 1945. Oxford: Oxford University Press. Mishkin, F.

S. (2010). The Economics of money, banking and financial markets (2nd ed.).

Upper Saddle River, NJ: Pearson Prentice Hall