FIFTY YEARS LATER

WHAT DO WE KNOW ABOUT THE GREAT CRASH?

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THE GREAT CRASH of October 1929 marked a fundamental break in U.S. history, a drastic change in basic attitudes and institutions that define the roles of citizen and state. Within about three years, stock prices were down to one-tenth of what they had been, real gross national product (GNP) had fallen by a third, industrial production was cut in half, and unemployment had hit a fourth of the labor force. Meanwhile, the public mind was affected as much as the economy, with the people turning to the government for security.

The terror of the Great Crash has been the failure to explain it. People were left with the feeling that massive economic contractions could occur at any moment, without warning, without cause. That fear has been exploited ever since as the major justification for virtually unlimited federal intervention in economic affairs.

From the obvious fact that it did not last, many conclude that the prosperity of the Twenties was in some sense phony or unreal. Actually, it was an enormously vibrant and creative decade. Real production per person increased by a whopping 42 per cent from 1921 to 1929. Life expectancy at birth rose by 5.6 years. There were more applications for patents in 1929 than in any year until 1965. From 1923 to 1929, unemployment averaged 3.3 per cent and inflation less than 1 per cent.

For reasons that range from puritanical to bolshevist, nearly everyone seems eager to blame the Thirties on the previous decade, rather than on policy blunders within the Thirties themselves. The Roaring Twenties are widely caricatured as a period of boozy self-indulgence, the extravagant sins of which required the penance of the Great Depression. The message is that progress should never again be really enjoyed; instead, rapid movement in living standards and stock values should be regarded as a symptom of incipient decay. To be doing well is to court disaster.

Some of these ascetic notions were recently revived by *Business Week* (September 3). They will be cited below not to chastise that journal (one of my favorites), but to highlight illusions so popular that they are still universally treated as facts:

► *Low Wages.* "Despite huge gains in productivity," writes *Business Week*, "wages actually fell for part or all of the 1920s." Actually, wage rates fell significantly only in 1921-22, when consumer prices also fell by more than 16 per cent. From 1922 to 1929, wage rates in manufacturing rose 17.3 per cent in real terms. In a period of comparable length, 1970 to 1977, real wage rates in manufacturing rose only 8.3 per cent.

► *Excess Profits.* From the incorrect assumption of falling wages, *Business Week* concludes that there was a "shift to profits . . . which pitched much of the income gain to high-saving high-income groups." The result was supposedly more savings than could profitably be used in expanding business investment "especially in 1928-29 as money from the 'shift to profits' sought productive uses. The surplus funds flowed into stock market speculation."

Business Week somehow argues that there was both too much and too little business investment: "business investment lagged through the late 1920s," but "capacity had been expanding at rates that could no longer be maintained." In fact, business fixed investment in 1929 was a robust 11.8 per cent of GNP—a figure unmatched since.

CORPORATE PROFITS, before taxes, averaged 8.2 per cent of national income in 1920-29—well below the 9.7 per cent share of the previous decade or the 14.1 per cent profit share in 1940-49. Conversely, the share of national income going to employee compensation averaged over 60 per cent in the Twenties, up from around 55 per cent in the previous two decades. There was no "shift to profits."

► *Excess Poverty.* "Almost 60 per cent of all of America's families," says *Business Week*, "earned less than the $2,000 a year needed in 1929 to buy the basic necessities." The cost of living today is about six times what it was in 1929, so that an income of $2,000 per "family" (which term actually includes single individuals) is comparable to $12,000 now —still well above any meaningful concept of basic necessities.

If most people couldn't afford to buy anything in 1929, why did personal-consumption spending amount to three-

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fourths of GNP in 1929, compared with 64 per cent last year? "Underconsumption" theories of the crash can't be reconciled with the evidence.

► *Excess Affluence.* "From 1919 to 1929," writes *Business Week*, "the share of disposable income received by persons in the top 1 per cent of the income distribution rose to 18.9 per cent from 12.2 per cent." The top rate of federal income tax was cut from 73 per cent in 1919-21 to 24 per cent by 1929, so more disposable (after-tax) income was reported in high income brackets. That doesn't mean the middle class got a significantly smaller share.

► *Farm Depression. Business Week* speaks of "sharply lower prices for farmers, while the goods they bought were rising in cost." But net income of farm operators (per farm) rose 4.6 per cent in 1928, 2.3 per cent in 1929. Prices received for both livestock and crops were up in 1928 and 1929; the "parity ratio" of farm costs to prices rose in both years and (at 92) was higher in 1929 than in any year from 1954 to the present. Farm prices and incomes were, of course, even higher during the inflationary boom of World War I, but so was the cost of living. Farm debt declined from 1923 to 1927, and then leveled off.

► *Housing Depression.* "A consumption boom," claims *Business Week*, "disguised the steepness of the housing depression." New houses were built at a hectic pace in 1922-27, doubling the previous record. Partly because of restricted immigration, housing starts dropped fairly sharply after April 1928, but they were still higher in 1929 than in any year before 1922. Moreover, the 1929 dip in housing was largely offset by a rise in nonresidential construction. A recent study by Professors Robert Gordon and James Wilcox refers to the "1927-29 collapse of construction." But a decline from the unusual $12.1-billion peak in 1926 to $10.8 billion in 1929 was hardly a "collapse"—it amounted to only about 1 per cent of national production.

► *Excessive Debt.* Among the causes of the Depression, according to *Business Week*, was "heavy borrowing by individuals, corporations, and governments." Increases in total private debt were 5.8 per cent in 1928, 3.7 per cent in 1929—not obviously out of line with the size and growth of incomes (after-tax personal income rose 7.5 per cent in 1929 alone). Government debt actually fell throughout the Twenties.

► *Inflation. Business Week* speaks of "loose money" and "the inflationary bubble that burst in 1929." One measure of the money supply (M2) rose by 2.4 per cent in 1927, 3.8 per cent in 1928, and not at all in 1929. A very broad measure of other liquid assets—including all sorts of savings deposits, commercial paper, bankers' acceptances, and Treasury bills—grew by 3.8 per cent in 1928 and fell slightly in 1929.

No credible price index shows any hint of inflation in the late Twenties. As a result, a discount rate of 6 per cent in late 1929 was very high in real terms. Money and credit were not "loose" at all, and there was no inflationary bubble.

If the Thirties can't plausibly be blamed on the Twenties, the logical next place to look is government policies adopted within the Depression itself. Actually, that makes more sense anyway, since our economy is far too resilient and adaptable to be long affected by the sorts of minor imbalances that some claim to find in the Twenties. Those who are producing for sale in free markets have every incentive not only to adapt quickly to changes, but to anticipate them. A market economy is a powerful stabilizing force, efficiently using the decentralized information of millions of people to adjust production and inventories to meet anticipated demands. It takes an enormous shock to throw the whole economy off course. Only the government has the power to deliver such an unexpected blow.

THE CONVENTIONAL wisdom, of course, is that the Crash of '29 was initiated by a wild speculative mania, creating a "bubble" that had to burst. Yet an enormous body of evidence has since shown that the stock market is extraordinarily efficient—that stock prices quickly reflect the best available information. The efficiency of financial markets suggests that the stock market could not have been enormously "overpriced" in September 1929, but must instead have absorbed some strikingly negative new information in the following months.

Actually, it was perfectly reasonable for stock prices to rise substantially after the mild recession of 1927. Average dividends per share rose 61 per cent from 1923 to 1929. Whole new industries, such as the manufacture of radios,

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were springing up. Production of autos, crude oil, and electricity more than doubled from 1920 to 1929.

If the Dow-Jones index of industrial stock prices is adjusted for the postwar inflation, the highest point on September 3, 1929 (1,212 in 1975 dollars) was no higher than the peak in 1960 (1,252) and well below the peak in 1966 (1,659). As of 1929, stock prices hàd doubled in a little over two years in this country, but they doubled in half that time in France, and did almost that well in Canada and Japan. Yet we do not speak of the crazy stock market boom of France in the late Twenties, nor of the insane speculative bubble of 1960 in this country.

If the stock prices were *not* way out of line with genuine business opportunities in September of 1929, as both theory and evidence suggest, then what could have happened to change the prospects so suddenly and dramatically? The answer was provided by Jude Wanniski in *The Way the World Works*: the stock market crash was caused by the increasing likelihood that the Smoot-Hawley tariff would pass.

Many scholars have long agreed that the tariff had disastrous effects, but most of them have felt that it could not have caused the stock market collapse of October 1929, since the tariff was not signed into law until the following June. Today we know that market participants do not wait for a major law to pass, but instead try to anticipate whether or not it will pass and what its effects will be.

Consider the following sequence of events:

The Smoot-Hawley tariff passes the House on May 28, 1929. Stock prices in New York (1926 = 100) drop from 196 in March to 191 in June. On June 19, Republicans on the Senate Finance Committee meet to rewrite the bill. Hoping for improvement, the market rallies, but industrial production (1967 = 100) peaks in July, and dips very slightly through September. Stocks rise to 216 by September, hitting their peak on the third of the month. The full Senate Finance Committee goes to work on the tariff the following day, moving it to the Senate floor later in the month.

On October 21, the Senate rejects, 64 to 10, a move to limit tariff increases to agriculture. "A weakening of the Democratic-Progressive Coalition was evidenced on October 23," notes the *Commercial and Financial Chronicle*. In this first test vote, 16 members of the anti-tariff coalition switch sides and vote to double the tariff on calcium carbide from Canada. Stocks collapse in the last hour of trading; the following morning is christened Black Thursday. On October 28, a delegation of senators appeals to President Hoover to help push a tariff bill through quickly (which he does on the 31st). The *Chronicle* headlines news about broker loans on the same day: "Recall of Foreign Money Grows Heavier —All Europe Withdrawing Capital." The following day is Black Tuesday, with a record loss of 38 points on the Dow.

Stocks continue falling until November 14. On that day, President Hoover announces a 1 per cent cut in personal and corporate tax rates, and Senator Smoot's proposal to rework the bill in committee is soundly defeated by forces vowing to rewrite it in open session. Shortly before, notes the *Chronicle*, a demoralized Senator Smoot offered to "virtually surrender the tariff bill to the Coalition of Progressives and Democrats." The Senate eventually postpones action on the bill until the next session. It looks like a stalemate. Stocks begin to rally after November 14, rising steadily from 145 in November to 171 in April. Industrial production stops falling and hovers around the December level through March.

On March 24, 1930, the Senate passes the Smoot-Hawley tariff, 222 to 153. Debate now centers on whether or not President Hoover will veto. Still, stocks drop 11 points, to 160, in May. On June 17, 1930, despite the vigorous protests of a thousand economists, Hoover signs the bill into law, noting that it fulfills a campaign promise he had made, and stocks drop to 140 in July.

The *Commercial and Financial Chronicle* dated June 21, 1930 led off with the major events of the week—"the signing by the President of the Smoot-Hawley tariff bill" and "a renewed violent collapse of the stock market." Without ever quite linking the two events, the *Chronicle* did observe that "if the foreigner cannot sell his goods to us he cannot obtain the wherewithal to buy our goods." Other sections noted that international stocks were particularly hard hit, that 35 nations had vigorously protested the tariff and threatened retaliation, and that Canada and other nations had already hiked their own tariffs "in view of the likelihood of such legislation in the United States."

IT MAY BE hard to realize how international trade could have so much impact on the domestic economy. For years, in explaining income movements in the Thirties, attention has instead been focused on federal spending and deficits. Yet on the face of it, trade was far more important: exports fell from $7 billion in 1929 to $2.5 billion in 1932; federal spending was only $2.6 billion in 1929 and $3.2 billion in 1932. In 1929, exports accounted for nearly 7 per cent of our national production, and a much larger share of the production of goods (as opposed to services). Trade also accounted for 15 to 17 per cent of farm income in 1926-29, and farm exports were slashed to a third of their 1929 level by 1933.

Even these numbers, however, understate the significance of trade. Critical portions of the U.S. production process can be crippled by a high tax on imported materials. Other key industries are heavily dependent on exports. Disruptions in trade patterns then ripple throughout the economy. A tariff on linseed oil hurt the U.S. paint industry, a tariff on tungsten hurt steel, a tariff on casein hurt paper, a tariff on mica hurt electrical equipment, and so on. Over eight hundred things used in making automobiles were taxed by Smoot-Hawley. There were five hundred U.S. plants employing sixty thousand people to make cheap clothing out of imported wool rags; the tariff on wool rags rose by 140 per cent.

Foreign countries were flattened by higher U.S. tariffs on things like olive oil (Italy), sugar and cigars (Cuba), silk (Japan), wheat and butter (Canada). The impoverishment of foreign producers reduced their purchases of, say, U.S. cotton, thus bankrupting both farmers and the farmers' banks.

It should be obvious that an effective limit on imports also reduces exports. Without the dollars obtained by selling here, foreign countries could not afford to buy our goods (or to repay their debts). From 1929 to 1932, U.S. imports from Germany fell by $181 million, U.S. exports to Germany fell by $277 million. Americans also had little use for foreign currency, since foreign goods were subject to prohibitive tariffs, so the dollar was artificially costly in terms of other currencies. That too depressed our exports, which turned out to be particularly devastating to farmers—the group that was supposed to benefit from the tariffs.

THERE HAD already been some damage done (particularly to farm exports) by the tariff legislation of 1921 and 1922. As Princeton historian Arthur Link points out, however, "its only important changes were increased protection for aluminum, chemical products, and agricultural commodities." Smoot-Hawley broadened the list to include 3,218 items (including sauerkraut), and 887 tariffs were sharply increased, on everything from Brazil nuts to strychnine. Clocks had faced a tariff of 45 per cent; Smoot-Hawley raised that to 55 per cent, plus up to $4.50 apiece. Tariffs on corn, butter, and unimproved wools were roughly doubled. A shrinking list of tariff-free goods no longer included "junk," though leeches and skeletons were still exempt.

A crucial consideration is that many tariffs were a specific amount of money per unit rather than a percentage of the price. As prices of many traded goods fell by half (or more) from 1929 to 1933, the effective rate of tariff doubled. If imported felt hats sold for $5, including a tariff of $2.50, a fall in price to $2.50 would confiscate the entire revenue from selling in the U.S. market. Without the dollars from selling in the U.S. market, the foreign hat manufacturer couldn't buy anything here.

A number of seemingly separate explanations of the Great Crash fit together quite well once the importance of anticipated tariffs is acknowledged. Charles Kindleberger, in *Manias, Panics, and Crashes*, describes some structural collapse in the financial system: "Lending on import, for example, seems to have come to a complete stop." But refusal to finance imports makes perfect sense if lenders were correctly anticipating steep tariffs ahead. There were early cancellations of import orders in 1929 that likewise reflected rational expectations, and import prices were among the first to fall.

A lot of stock was being bought on margin—that is, the buyer put up 25 to 50 per cent of the price and his broker went to the bank to borrow enough to cover the rest temporarily. The chairman of the Federal Reserve Board had warned the banks to curb these broker or "call" loans as early as February 1929, and the Fed nearly doubled the discount rate from 1927 to August 1929, partly in the hope of curbing stock market "speculation." Most of the broker loans in 1928-29 were not from the banks themselves, however, but were instead re-lent to brokers on behalf of domestic business and foreign banks, businesses, and individuals.

The massive withdrawal of foreign lenders from the broker-loan market in early October probably reflected the correctly anticipated decline in the value of the collateral for those loans (stocks), and the fear among foreign capitalists that they would have to liquidate such assets to stay solvent in a world of high tariffs. The process contributed to the crash as both cause and effect. There was a scramble for liquidity by both the lenders and the owners of stocks. As stock prices fell, brokers required that their customers put up more money to meet the margin requirement. If stockholders couldn't come up with the cash, brokers could sell the securities to raise the money. Either way, owners and brokers were pressed to unload stocks, thus perhaps accelerating (but not causing) the stock market decline.

The market suffered continual policy assaults after 1930. In early April of 1932, the *Commercial and Financial Chronicle* reports "the market fell into a complete collapse . . . owing to the approval by the House of Representatives of an increased tax on stock sales." The Dow bottomed on July 8, when (as the *Chronicle* of the following day reported) there had been some good news—the Tariff Commission had trimmed 18 tariffs, and a House subcommittee was looking into ways to cut taxes by eliminating duplication with states. On Tuesday, September 19, candidate Roosevelt called the tariff "the road to ruin" and pledged to negotiate reductions in tariffs as soon as he took office. The following Saturday, the *Chronicle* was astounded that the "market again sharply reversed its course, and on Wednesday prices suddenly surged upward in a most sensational fashion."

THE OVERWHELMING issue after Smoot-Hawley was accelerating deflation—a general decline in prices or increase in the purchasing power of money. As measured by the broad GNP deflator, prices fell by 3.3 per cent in 1930, 9.1 per cent in 1931, 11.2 per cent in 1932, and 2.1 per cent in 1933. A chuck roast that sold for 31 cents a pound in 1929 went for 16 cents in 1933.

Many enduring myths about the early Depression simply reflect failure to adjust for the rising value of the dollar. It is still said, for example, that there must have been as much money as people wanted to borrow since interest rates were so low. Short-term business loans in major cities went for 4.7 per cent in 1932; a Manhattan mortgage could be obtained at 5.8 per cent. Since prices were falling by 11 per cent a year, however, those rates were roughly 16 to 17 per cent in real terms—equivalent to nominal rates of 30 per cent at today's rate of inflation. Actually, the fact that the dollar was rising in value against goods is a sure sign that people wanted to hold more money than there was, and were willing to dump goods to get it.

The initial trigger of deflation was the collapse of over five thousand banks, at the rate of about three hundred banks a month after October 1930. Perfectly sound foreign loans turned bad as foreign exporters were shut out of our market. Broker loans turned bad as foreign and domestic stockholders, and those lending against that collateral, re-

considered the earnings potential of firms in a shrunken world market. Above all, farm loans turned bad as farm export potential and prices faced collapse as a result of the deliberate impoverishment of foreign customers. As Professor Allan Meltzer has emphasized, rural banks were hit particularly hard by Smoot-Hawley.

Failure of a few banks soon toppled others, as people rushed to pull their money out. Banks couldn't convert all their loans and securities into cash quickly enough without bankrupting their borrowers or losing money by selling bonds cheap. The Federal Reserve, set up to prevent bank runs, did almost nothing in the way of supplying the banks with more reserves or lending them money against securities. Instead, it hiked the discount rate by two percentage points in early 1932.

Between August 1929 and March 1933, some 36 per cent of the nation's money simply disappeared. That was, of course, the startling discovery Milton Friedman and Anna Schwartz made in 1963, in their *Monetary History of the U.S.* It was not widely noticed at the time. The October 1934 letter from National City Bank of New York reported that "at no time since 1929 has the stock of money been less than in that year." That statement makes sense only if one doesn't count deposits in banks as money.

In fact, when banks collapsed, their deposits ceased to be money. When people don't have as much money, they can't spend it as fast. With a fall in total spending (nominal GNP), either prices or quantities bought also had to come down. The U.S. Government actively resisted the downward adjustment of prices, particularly the price of labor, with the predictable result that more of the decline was reflected in production than was the case in Europe.

Deflation had serious effects. For one thing, the real burden of debt rose sharply. Promises to pay a certain number of dollars in the future naturally lead to widespread bankruptcies and defaults when the flow of dollar incomes is much less than expected. And there are other expenses that may be fixed by long-term contracts, such as commitments to pay a certain price for future delivery, or wage contracts with labor unions. When spending and prices fall, such contracted costs may wipe out any margin for profit, resulting in layoffs or plant closings.

There was (and still is) a widespread confusion of wage rates per hour with total income actually received by workers. As *Business Week* puts it, "a reduction in wages lowers a worker's income and therefore reduces even further the total demand for goods in the economy." This is exactly like saying that Chrysler should not cut prices to sell more cars because the company would make more profit at a higher price.

If wage rates are kept up while prices are falling, labor costs soon wipe out any profit margin. The firm must at least lay off workers and possibly shut down. It is little comfort then to know that if jobs were available they would pay a higher wage rate. Pricing workers out of a job does not raise their income and aggregate demand. The higher wage rate simply cannot be paid, because consumers cannot or will not pay a price high enough to cover the cost.

Consumer prices fell 25 per cent by 1933, wholesale prices fell 31 per cent. "Wages," says *Business Week*, "suffered even sharper cuts." That simply is not true. Hourly wages of production workers in manufacturing declined significantly only in 1932, although consumer prices were falling sharply. As a result, *real* wage rates in manufacturing rose by 4.3 per cent from 1929 to 1933 (and by another 26.6 per cent from 1933 to 1937). In union building trades, wage rates rose even in nominal terms from 1929 to 1931—in the face of total collapse of construction. Even by 1933, *real* wage rates in union building trades were 15.3 per cent higher than in 1929. Real wage rates in coal mining were essentially unchanged from 1929 to 1933, but then rose 63.4 per cent by 1939.

In a 1931 article in *Essays in Persuasion*, Lord Keynes showed that he understood the consequences quite well: "The fall in prices relative to costs," wrote Keynes, "together with the psychological effect of high taxation, has destroyed the necessary incentive to production." There is, he added, "no possible means of curing unemployment except by restoring to employers a proper margin of profit."

President Hoover jawboned vigorously on behalf of keeping nominal wage rates up while prices were falling—that is, on behalf of rising unemployment. It apparently worked until 1932, at least within the most visible industries. Real wage rates rose in manufacturing and construction; employment plummeted.

Then we were hit with the National Recovery Act (NRA) from June 1933 to May 1935. With industry producing less than half of what it had produced in 1929, President Roosevelt somehow decided that we had to prevent "foolish overproduction." The NRA certainly did that, by preventing many prices and wage rates from adjusting to the shrunken money supply. With less production, of course, came less employment.

Real GNP had increased 12 per cent from the third quarter of 1932 to the second quarter of 1933; with NRA, production dropped almost 10 per cent in two quarters and stumbled along with little progress until the program ended. Industrial production was higher when the NRA started than when it ended.

As if things weren't bad enough, in 1932 the Hoover Administration put through the biggest percentage increase in taxes in peacetime history. A family earning $10,000 with four exemptions paid $40 in 1929, $416 in 1932. Roosevelt hiked taxes again in 1935 and almost routinely thereafter. By 1938, the corporate tax rate had gone from 11 to 19 per cent, top estate tax rates from 20 to 70 per cent, and top income tax rates from 24 to 79 per cent; in addition, new taxes had been levied on gifts and on jobs (payrolls). Since productive effort and investment depend largely on after-tax rewards, tax policy was well designed to encourage stagnation.

There was nonetheless a brief respite and recovery until 1937-38, when additional destructive policies created a sharp recession within a depression. Real GNP soared by 13.4 per cent in 1936. But minimum wage rates were enacted in 1937, and the Wagner Act, strengthening unions, was declared constitutional. There were more strikes in 1937 (4,720) than in any year between 1951 and 1967. Monetary policy was substantially tightened in 1937, with sharp increases in the discount rate and reserve requirements, and

total spending (nominal GNP) fell by 6.4 per cent in 1938. With wage rates again being pushed up and prices again falling, real wage rates and unemployment shot up, the stock market fell.

Public service jobs were financed by taxes and tariffs on productive activity, and the make-work jobs prevented the efficient relocation, adaptation, and use of skills. Unemployment rates were exaggerated by around five percentage points because nearly four million people in public-service employment were (with some justification) counted as not working.

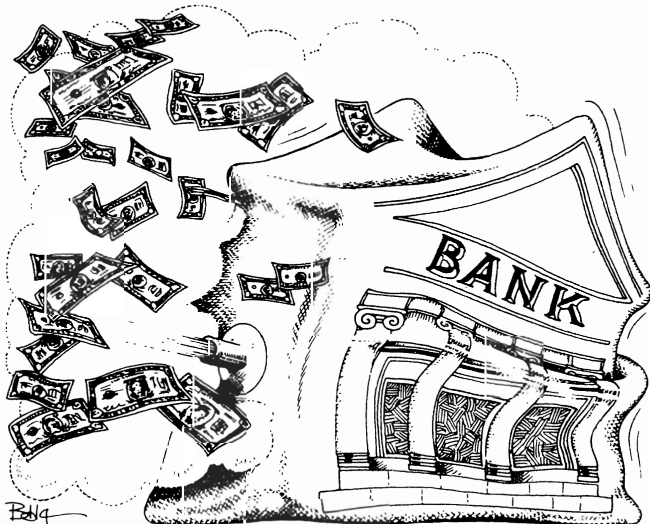
In January 1939, President Roosevelt announced the end of New Deal "reforms." Real output rose by 7.6 per cent in that year, followed by increases of 7.7 and 16.1 per cent in 1940 and 1941.

It is often said that the federal deficits of World War II pulled us out of the Depression, but that is misleading. Deficit spending was not significant until 1942, and it peaked in 1945 when measured real growth was less than half of what it was in 1941. Unemployment rates obviously looked much better, because the armed forces in 1945 were as numerous as the unemployed in 1934. Living standards, however, declined in the war. Consumption of durable goods fell 45 per cent from 1941 to 1945, and was no higher per person in 1944 than in 1932-33. The nation's real stock of capital fell 5 per cent from 1939 to 1944.

Measures of inflation were wildly understated during the war, because they failed to account for black markets and subsidies. As a result, real output and income figures were exaggerated by understating true costs. Even so, measured real earnings of workers did not rise at all from 1943 to 1948.

After-tax real profits, however, doubled from 1939 to 1944 and then doubled again by 1948. The improvement that undoubtedly did occur in business conditions was due to lowering real wage rates through wage controls and inflation. The profit share of National Income was 4.9 per cent in 1930-39, 14.1 per cent in 1940-49.

Inflation also helped to reduce the bite of Smoot-Hawley tariffs by about half. Tariffs were also cut explicitly, though gradually, after Secretary of State Cordell Hull pushed through the Reciprocal Trade Act of 1934. Average tariffs



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on dutiable imports fell from almost 60 per cent in 1931 to 18.7 per cent in 1944-53, and the list of dutiable imports also shrank. Further tariff reductions followed the establishment of the General Agreement on Tariffs and Trade in 1948, and the Kennedy Round of tariff cuts in 1962-67. As a result, world trade expanded by 8.2 per cent a year from 1956 to 1970, pulling most of the world's economies up through efficient specialization and exchange.

What happened during World War II is that we undid the depressing squeeze on profit margins and world trade, largely by inflating our way out of legislated costs.

Could the Great Crash happen again? In one sense, it already has. Professors Lawrence Fisher and James Lorie calculate that the real after-tax return on stocks was *minus* 6.6 per cent a year from 1929 to 1933; from 1972 to 1976, the annual real return to stockholders was about the same —minus 6.2 per cent. The duration of the Depression, however, was caused by more than "just" the stock market collapse.

Protectionism is certainly still a threat, though it now takes more subtle forms such as "voluntary" quotas. It is no coincidence that world trade has grown only half as fast in recent years as it did in the Sixties. Destructive rates of taxation are quite possible too, though they now occur through the effect of inflation in creating illusory profits, interest earnings, and capital gains to be taxed, and in pushing individuals into higher brackets. Least likely to be repeated is a massive collapse of the money supply. Deposit insurance does seem to keep bank runs from spreading, and the Federal Reserve has mastered the art of inflating.

There are some structural changes that probably prevent massive unemployment. For one thing, the service sector now accounts for nearly two-thirds of all employment. Spending on services (being harder to postpone) is not subject to the sharp swings that can hit construction and durable goods manufacturing.

The most commonly cited reasons for optimism are less plausible. The hope that improved economic management will protect us is now confronted with the third recession in a decade combined with the worst inflation in peacetime history. The old idea that unemployment benefits provide automatic stabilizers likewise clashes with growing evidence that such benefits lengthen unemployment and encourage activities leading to unemployment.

Perhaps the best reason to expect that a Great Depression will never again occur is that a small but growing band of scholars are finally beginning to grasp what caused it—namely, tariffs, taxes, monetary mismanagement, and political manipulation of wage rates and prices. Once the tail is placed on the right donkey, we at least know what to watch out for. □