Reflections on *A Monetary History*

Milton Friedman

It is a source of real gratification that Anna Schwartz's and my book should be deemed worthy of a retrospective after 40 years. The extensive research of the past 40 years plus the additional 40 years of history certainly require many modifications in detail in the story as we told it. However, I believe that our major themes have held up remarkably well. The most controversial of those—our attribution to the Federal Reserve of a major share of the responsibility for the 1929–33 contraction—has become almost conventional wisdom. Money does matter.

The Fed's Performance

In an April 15, 1988, *Wall Street Journal* op-ed, I wrote, "No major institution in the U.S. has so poor a record of performance over so long a period as the Federal Reserve, yet so high a public recognition." That conclusion was, I believe, amply justified by our book and experience in the quarter century after its publication. Fortunately, as I wrote in a *Wall Street Journal* op-ed of August 19, 2003 ("The Fed's Thermostat"), it no longer is.

Since the mid-1980s, central banks around the world have reacted to the mounting evidence of monetary research by accepting the view that their basic responsibility is to produce price stability. More important, they have succeeded to a remarkable extent as they have discovered that, far from there being a tradeoff between price stability and economic stability, they are mutually supporting. The variability of prices is less by an order of magnitude since the mid-1980s than it was before, not only in the United States, but also in New

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Zealand (the first country to adopt an explicit inflation target), Great Britain, Euroland, Japan, and elsewhere.

Their success in controlling inflation has altered the empirical relation between short-term movements in money and in nominal income. Achieving price stability requires offsetting changes in velocity by opposite changes in the quantity of money, which reduces sharply the correlation between short-term movements in money and short-term movements in nominal income. To put it differently, short-term changes in the quantity of money can no longer be regarded as largely exogenous. They have become largely endogenous. If the central banks continue to be successful in curbing price fluctuations, they will have converted the quantity of money from an unruly master to an obedient servant.

The generalization that long-term changes in the quantity of money are reflected primarily in prices and little if at all in real output remains valid.

The Role of France

Reading the English translation of the memoirs of Emile Moreau (Governor of the Bank of France, 1926–28) persuaded me that we understated the role of France in the international transmission of the contraction. As I wrote in a foreword that I contributed to that book,

> Had I fully appreciated these subtleties [in the French version of the memoirs] when Anna Schwartz and I were writing our *A Monetary History of the United States*, we would likely have assigned responsibility for the international character of the Great Depression somewhat differently. We attributed responsibility for the initiation of a worldwide contraction to the United States and I would not alter that judgment now. However, we also remarked "The international effects were severe and the transmission rapid, not only because the gold-exchange standard had rendered the international financial system more vulnerable to disturbances, but also because the United States did not follow gold-standard rules." Were I writing the sentence today, I would say, "because the United States and France did not follow gold-standard rules" [Moreau, Stoller, and Trevor 1991: xii].

Velocity

On the final text page of our book, we referred to the contrast between the downward secular trend of velocity before World War II, and the upward trend in the postwar period. And went on to say that "we expect the secular decline to be resumed. But . . . we shall have

to wait for experience to unfold before discriminating finally among the alternative explanations."

Forty years of additional experience has now unfolded and, instead of declining, velocity has continued to rise at about the same secular rate as in the immediate postwar period. I believe we do not yet have an adequate explanation of why prewar and postwar trends have been in opposite directions.

A Final Comment

I cannot close without saying what a joy it was to collaborate for more than a quarter of a century with Anna Schwartz. As in all fruitful collaborations, neither of us alone could have produced *A Monetary History.* But the collaboration could have been fruitful without being pleasurable. Fortunately, it was both.

References

Moreau, E.; Stoller, S. D.; and Roberts, T. C. (1991) *The Golden Franc*. Boulder, Colo.: Westview Press.