

A Monetary History Of The United States PDF (Limited Copy)

Milton Friedman



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A Monetary History Of The United States Summary

The Impact of Monetary Policy on American Economic History

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About the book

"A Monetary History of the United States," written by Milton Friedman and Anna Schwartz, is a comprehensive examination of the pivotal influence of monetary policy on the U.S. economy. This seminal work delves into historical data and offers a detailed analysis of how money supply management can mitigate economic fluctuations, especially during crises.

One of the key chapters, "The Great Contraction," focuses on the profound economic downturn of the Great Depression, illustrating how inadequate monetary intervention exacerbated the financial turmoil of the era. Friedman and Schwartz argue that the Federal Reserve's failure to effectively regulate the money supply contributed to the depth and duration of the depression. They advocate for a proactive monetary policy to stabilize the economy, emphasizing that the ability to control the money supply can prevent severe economic contractions.

The authors' insights challenge conventional economic thought of their time, positing that sound monetary policy is fundamental for sustaining healthy market economies. Their work ultimately earned them the Nobel Prize in Economic Sciences in 2000, reflecting the lasting impact of their findings and the relevance of their analysis for contemporary economic understanding. Overall, the book serves as an essential resource for comprehending the intricate dynamics of monetary policy and its critical

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role in shaping economic outcomes throughout U.S. history.

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About the author

Milton Friedman emerged as a towering figure in American economics, shaping the landscape of free-market thought throughout the 20th century. Born on July 31, 1912, in Brooklyn, New York, he pursued higher education at Columbia University, where he cultivated revolutionary ideas that would later revolutionize modern economics.

After earning his Ph.D., Friedman became a prominent critic of Keynesian economics, which emphasized active government intervention in the economy. Instead, he championed the role of monetary policy, arguing that monetary stability is crucial for economic prosperity. His groundbreaking theories on consumption, illustrated in the "Permanent Income Hypothesis," posited that individuals make spending decisions based on expected long-term income rather than current income.

Friedman's influential career reached new heights when he was awarded the Nobel Prize in Economic Sciences in 1976 for his profound insights into monetary history and the interplay between government and economic activity. At the University of Chicago, where he served as a respected professor, his ideas flourished and disseminated, significantly impacting public policy discussions on economic freedom and government intervention.

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One of his most notable contributions, "A Monetary History of the United States," co-authored with Anna Schwartz, critically examined the role of monetary policy in historical economic events, emphasizing how mismanagement of the monetary system led to crises like the Great Depression. This work not only solidified his reputation as an economist but also as a public intellectual.

Through various writings and public appearances, Friedman advocated for individual liberties, limited government, and the virtues of economic freedom, ensuring that his legacy would influence thinkers and policymakers for generations to come. His profound belief in the power of the free market continues to resonate in contemporary economic debates, establishing him as a central figure in the discourse surrounding economic policy and individual rights.

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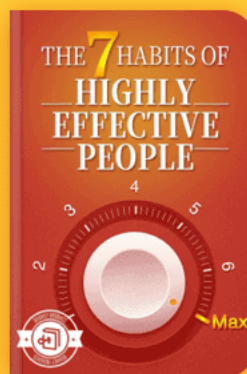
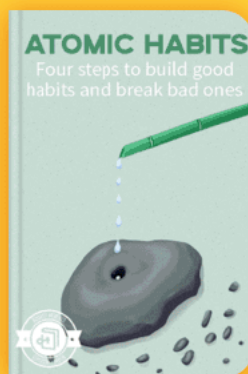
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Chapter 1 Summary: - Introduction

Chapter 1: Introduction

This book explores the evolution of the United States money supply from shortly after the Civil War until 1960, analyzing the various factors that have influenced its growth and impact on both economic and political landscapes. Beginning in 1867 allows the authors to work with more reliable data, as earlier periods present significant gaps in information. While comprehensive, the study is selective, concentrating on the continuity of the money supply and its historical significance.

Historical Overview of Money Supply

The authors present the first estimates of the money supply over 93 years, revealing a remarkable increase from approximately \$1.59 billion in 1867 to around \$242 billion by 1960. This growth corresponds with significant historical developments and population expansion, resulting in a dramatic rise in money per person, indicative of broader economic changes.

Changes in Monetary Policy and Economic Events

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This section analyzes the fluctuating monetary standards and crises that shaped the U.S. economy post-Civil War, including intense debates regarding the gold and silver standards. It highlights banking crises that challenged the stability of the financial system. A pivotal moment in this narrative is the establishment of the Federal Reserve System in 1914, which aimed to create a more structured approach to monetary policy, addressing earlier periods of instability.

Impact of World Events on Monetary Stability

The influence of global events, particularly World War I and the Great Depression, is examined in detail, illustrating how these crises impacted the money supply and banking practices in the U.S. The government's response to banking failures is critiqued, spotlighting initiatives like federal deposit insurance aimed at stabilizing the financial system during turbulent times.

Post-World War II Developments

Following World War II, the U.S. moved away from fixed ties to gold, adopting various economic policies to stabilize the money supply. Despite these adjustments, inflationary pressures began to rise, prompting renewed

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scrutiny of monetary policy and shifting public expectations regarding economic stability.

Conclusion

The chapter summarizes nearly a century-long evolution of U.S. monetary policy, underscoring the Federal Reserve's potential to manage the money supply while acknowledging that its effectiveness has often been overshadowed by broader economic conditions and policy choices. This foundation sets the stage for a detailed examination of monetary history in the chapters that follow, promising a thorough exploration of the intricate relationship between money, economy, and society in America.

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Chapter 2 Summary: - The Greenback Period

Summary of Chapter 2: The Greenback Period

Overview of the Greenback Era

The Greenback Era, spanning from the end of the Civil War in 1865 until the resumption of gold payments in 1879, was a transformative time for the U.S. banking system and monetary policy. It marked the creation of the National Banking System and the introduction of a fiduciary monetary standard in which the government ceased selling gold. This led to a unique situation of floating exchange rates between U.S. currency and other currencies—something that would not reoccur until the early 20th century.

1. Composition of the Stock of Money in 1867

At the close of June 1867, the U.S. money stock was chiefly composed of currency and deposits, with the ratio of deposits to currency standing at approximately \$1.20 for every dollar of currency. By 1872, this inclination towards deposits surged, reflecting a societal shift favoring bank deposits as a preferred form of money, leading to a doubling of deposits relative to currency.

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2. Changes in Money, Income, Prices, and Velocity

Between 1867 and 1879, fluctuations in the money stock mirrored the broader economic context, with only a 17% increase in money supply over this period. Despite a significant decline in prices—a surprising phenomenon—rapid economic growth ensued, presenting a paradox where falling prices did not signify stagnation, but rather a thriving economy.

3. The Politics of Resumption

Post-Civil War political dynamics shifted from an initial consensus on resuming specie payments to rising divisions that included calls for currency expansion. This heated political climate ignited debates in Congress about the greenback's future role in the economy, culminating in the Resumption Act of 1875, which aimed to restore the currency's link to gold.

4. Factors Accounting for Changes in the Stock of Money

Changes in the money supply were primarily influenced by three determinants: high-powered money (the base money in the economy), the ratio of bank deposits to reserves, and the ratio of deposits to currency. Factors such as government policy, public confidence in financial systems, and the prevailing economic climate significantly shaped these ratios.



5. Special Problems Connected with the Greenback Period

The Greenback Period was also marked by challenges, notably the premium on gold and the overall stock of gold. Gold prices fluctuated driven more by international demand and supply factors than domestic issues. The path toward the resumption of gold payments in 1879 necessitated that U.S. prices realign closely with those in countries adhering to the gold standard, particularly in light of rapid productivity growth during this time.

6. Summary

From 1862 to 1879, the U.S. dollar operated without an official gold link, leading to notable volatility in the greenback's value against gold. This era was defined by significant price declines necessary for a successful return to prewar gold parity. The remarkable growth in economic output during this period eventually laid the groundwork for favorable conditions for resuming gold payments, contradicting the common notion that price alterations directly correlate with economic stagnation.



Chapter 3 Summary: - Silver Politics and the Secular Decline in Prices, 1879-97

Summary of Chapter 3: Silver Politics and the Secular Decline in Prices, 1879-1914

The Gold Standard and Money Dynamics (1879-1914)

In 1879, the United States returned to the gold standard, fundamentally shifting the dynamics of its monetary policy. Rather than being swayed primarily by domestic conditions, the money supply became increasingly anchored to international economic factors. This transition created a scenario where domestic price levels and income were heavily influenced by global market trends, introducing significant volatility into the U.S. economy.

Economic Trends and Price Fluctuations

The economic landscape during this period can be divided into two distinct phases. From 1879 to 1897, despite a substantial increase in the money supply, the country experienced a general decline in prices. This perplexing deflation occurred even as gold discoveries surged in the 1890s, prompting a reversal with rising prices. Notably, the era leading up to this price decline was marked by political unrest and fervent debates over monetary policy, particularly the advocacy for silver to bolster inflation. However, after the 1896 election, which saw the gold standard solidified, these silver-focused grievances diminished significantly.

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Monetary Growth Rates and Economic Conditions

During the initial phase from 1879 to 1897, the average money stock grew by approximately 6% annually, reflecting substantial fluctuations driven by economic activity. Despite the monetary instability, the period saw meaningful economic growth. From 1897 to 1914, the growth rate climbed to an average of 7.5%, coinciding with rising price levels, suggesting a responsiveness of the economy to the evolving monetary landscape.

Movement of Money and Financial Crises

This chapter recounts a series of economic cycles that included both expansions and severe downturns, necessitating adjustments in monetary policy and prompting an expansion of the money supply. The banking panic of 1893 serves as a critical example, illustrating the vulnerabilities of the financial system under stress and highlighting the Treasury's role in stabilizing monetary markets.

The Politics Surrounding Silver

The discord over silver stems from the earlier legislative decision to demonetize silver coins, a move seen as favoring wealthy Eastern bankers at the detriment of silver miners and agrarian interests. This spurred a growing movement for "free silver," as farmers and various political groups coalesced around the cause. The 1896 presidential election became a crucial battleground for silver supporters, amplifying anti-gold sentiments.



However, following the electoral victory and an influx of international gold, the gold standard regained its preeminence.

Factors Driving Changes in Money Stock

Changes in the money stock were primarily influenced by international trends and the broader U.S. economic context. The interplay of capital inflows and domestic financial policies, particularly actions taken by the Treasury (notably silver purchases), significantly shaped monetary stability.

Conclusion

This chapter underscores the complex interplay between monetary policy, economic trends, and political movements in the United States from 1879 to 1914. It reveals how external pressures and domestic policies molded the economic landscape, epitomizing the contentious debates surrounding the gold standard and silver that ultimately shaped U.S. monetary policy during a transformative period in financial history.



Chapter 4: - Gold Inflation and Banking Reform, 1897-1914

Chapter 4 Summary: Gold Inflation and Banking Reform, 1897-1914

Price Movements and Gold Supply

From 1897 to 1914, the United States experienced a notable increase in prices, with an average rise of 40-50%, largely fueled by a global surge in gold supply. This rise was attributed to significant gold discoveries in South Africa and improvements in mining techniques. Consequently, the U.S. gold stock soared from \$591 million to \$1,891 million, leading to inflation characterized by a consistent annual wholesale price increase of approximately 2%.

Economic Recovery (1897-1902)

The U.S. economy began to recover from the previous economic depression in 1897, ushering in a period of substantial growth in the money supply and overall economic activity. By 1902, the net national product saw significant gains, reinstating robust business performance despite a short-lived contraction between 1899 and 1900. This resilience underscored a turning point in the nation's economic narrative.

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Balance of Trade and Gold Flows

During this time, the U.S. trade balance shifted dramatically thanks to favorable agricultural conditions and tariff structures, resulting in record export surpluses. This booming trade environment led the country to become a net importer of gold, marking a significant change in its monetary dynamics starting in 1897.

Events Leading to Panic (1902-1907)

The years from 1903 to 1906 brought continued economic growth, spurred on by heightened immigration and industrial progress. However, this optimistic environment also gave rise to speculative stock market activities, increasing the likelihood of financial instability. The culmination of these risks was the Panic of 1907, a crisis marked by a dramatic drop in stock prices and diminished public confidence, resulting in tightening of bank payments.

Response to Panic and Banking Reform

In the aftermath of the Panic, there was intense demand for banking reform. The rigidity of the existing banking system was exposed, leading to calls for a more flexible monetary framework. This outcry ultimately resulted in the



establishment of the Federal Reserve System in 1913, which aimed to address the systemic issues highlighted during the crisis and improve the standard of banking operations going forward.

Postpanic Period (1908-1914)

Following the Panic of 1907, the U.S. entered a recovery phase characterized by moderate economic growth and fluctuations leading up to the onset of World War I. Reforms introduced during this period played a crucial role in stabilizing the monetary situation, enhancing the interplay between currency and bank deposits.

Money Stock Dynamics

Throughout this transformative period, the dynamics of the money stock were influenced by various factors, including fluctuations in high-powered money and changes in deposit ratios as well as currency demand. This growth trajectory highlighted a complex interrelationship between monetary policies, economic conditions, and external influences.

Concluding Comparison

In summation, this chapter provides a comparative examination of critical phases in U.S. monetary history, emphasizing the structural changes and

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price adjustments catalyzed by gold inflation and banking reform. The lessons gleaned from this period established a framework for future monetary policy, illustrating the intricate connections between economic activity, money flow, and institutional integrity, and setting a foundation for ongoing financial evolution.

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Chapter 5 Summary: - Early Years of the Federal Reserve System, 1914-21

Chapter 5: Early Years of the Federal Reserve System, 1914-21

Overview

The Federal Reserve Act was enacted in 1913 amid relative economic stability, but the onset of World War I disrupted this tranquility, leading to complex challenges within the U.S. monetary and banking systems. Key changes, such as the abandonment of the gold standard and legislative adjustments, transformed financial dynamics in the country.

1. Changes in the Monetary and Banking Structure

The primary purpose of the Federal Reserve Act was to establish an “elastic currency,” which allowed the dynamic adjustment of the money supply in response to economic conditions. This new system replaced traditional forms of high-powered money with Federal Reserve notes and deposits that banks could use as reserves. However, difficulties arose regarding the interpretation of the powers held by the Federal Reserve Board and the individual Federal Reserve Banks, creating a lack of clarity in authority. The intent behind having an elastic currency relied on legislative guidelines,

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which, due to the strains of wartime, soon proved ineffective.

2. Wartime and Postwar Inflation

As the U.S. entered World War I, the initial economic landscape contracted, but the war's demand for military and consumer goods quickly reversed this trend, triggering rampant inflation. Wartime expenditures surged, leading to an increased money supply as the government leaned heavily on credit rather than pre-existing financing methods. This shift complicated the balance of payments and altered price structures on an unprecedented scale, as the traditional gold flow that underpinned the monetary system was disrupted.

3. The Contraction of 1920-21

Following the wartime inflation, the Federal Reserve responded in early 1920 by raising discount rates to combat inflationary pressures. This move sparked a major economic contraction characterized by a sharp decrease in prices, leading to widespread economic hardship. The timing of the Federal Reserve's monetary policies came under scrutiny, as critiques highlighted their inadequacy and poor timing, leading to a deepening recession that stressed the newly formed central banking system.

Key Changes Introduced

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- Federal Reserve notes emerged as a new high-powered money form designed to enhance monetary flexibility.
- Control over the money supply evolved, reliant on a mix of banking authority and fluctuating legislative criteria.
- The impact of World War I precipitated significant inflation, which was later followed by deflation during the contractionary phase of 1920-21.

Concluding Observations

The early performance of the Federal Reserve revealed the inherent vulnerabilities and limitations of its newly established monetary controls under the strain of global conflict and economic upheaval. The lack of historical precedent in managing such dramatic shifts, alongside erratic external demands, resulted in fluctuating policies that exerted considerable influence on the national economy, setting the stage for future monetary policy developments in the United States.



Chapter 6 Summary: - The High Tide of the Reserve System, 1921-29

Chapter 6: The High Tide of the Reserve System, 1921-29

This chapter explores the transformative years of the U.S. economy and monetary policy between 1921 and 1929, a period known informally as the "new era" due to its remarkable economic growth and stability.

Economic Growth and Bank Changes

Following a brief recession in the early 1920s, the U.S. experienced a significant expansion. This period saw a restructuring within industries and finance, which altered the traditional role of commercial banks. These institutions began diversifying beyond standard banking functions to include fiduciary operations and involvement in securities markets. The chapter highlights the troubling decline of small-town banks, which contributed to an alarmingly high failure rate among banks, signaling shifts in banking practices and regional economic stability.

Federal Reserve System Dynamics

During this decade, the Federal Reserve emerged as a more autonomous

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entity, increasingly detached from the constraints of the gold standard. The Fed began to explore its powers actively, aiming to foster economic stability and buffer against financial crises. This shift garnered scholarly interest, prompting a surge in studies focused on the Fed's evolving practices and policies, marking this time as crucial for understanding modern monetary frameworks.

Monetary Metrics: Money, Income, Prices, and Velocity

As industrial production and money supply surged, the chapter carefully examines the stability of prices during this expansion. The Fed faced challenges in maintaining this balance, particularly with mild recessions occurring in 1923-24 and 1926-27. Its actions reflected an attempt to manage the growth of money supply while curbing excess speculation in the stock market, highlighting the tension between stimulating the economy and controlling financial risk.

Commercial Bank Operations

Increased focus on securities and real estate lending marked a significant evolution in the credit operations of commercial banks. By the end of the decade, the chapter notes a stark decrease in commercial loans, paired with a surge in investments in securities and real estate. This shift raised concerns regarding credit quality, especially as the burgeoning stock and real estate



markets faced rising defaults and foreclosures, indicating underlying vulnerabilities in lending practices.

Development of Monetary Policy

The initial discussions around monetary policy emerged cautiously, with the Fed articulating vague and defensive goals. Key strategies included maintaining a balanced approach to open market operations and discounting, yet internal disagreements surfaced on how to effectively control stock market speculation. These disputes signaled a shift of power from the regional Federal Reserve Banks to the central Board, foreshadowing future conflicts in monetary governance.

Bank Suspensions and Monetary Control

The chapter documents a notable spike in bank suspensions, primarily affecting smaller institutions, attributed to both changing economic conditions and structural transformations within the banking sector. The Fed's approach relied heavily on indirect measures to influence monetary flow, carefully balancing discount rates and open-market operations to mitigate broader economic disturbances.

Summary of Policy Outcomes

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While the decade was marked by relative prosperity, the chapter concludes that the intertwined roles of monetary policy and external factors in shaping economic outcomes became increasingly evident. The Fed's struggle to effectively manage growth while curtailing speculative excess created a precarious environment, underscoring the limitations of its policy actions. Ultimately, this period laid the groundwork for future government responsibilities toward economic stability, which would become foundational to later monetary policy frameworks, emphasizing the challenges of balancing prosperity with financial regulation.

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Chapter 7 Summary: - The Great Contraction, 1929-33

Chapter 7 Summary: The Great Contraction, 1929-33

Overview of the Contraction

The period between 1929 and 1933 marked the most severe economic contraction in U.S. history, characterized by an alarming drop in net national product and significant declines across various economic indicators. This era witnessed a drastic reduction in the money supply, leading to widespread banking failures that deepened the financial crisis.

Monetary Behavior During Contraction

From August 1929 to March 1933, the money supply plummeted by over one-third, severely impacting the banking sector. As a result, more than 20% of U.S. banks halted operations, and the total number of banks shrank by over a third. In response to this crisis, sweeping bank holidays were declared to restore some order to the financial system.

Comparative Analysis of Past Contractions

This monetary collapse was unprecedented in its severity, with only the

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contraction from 1839 to 1843 drawing a distant comparison. The events of this period significantly shifted public and academic perceptions regarding the effectiveness of monetary policy, eroding confidence in governmental interventions.

Impact on Economic and Monetary Institutions

The Great Contraction prompted the establishment of crucial monetary institutions, reforms in the Federal Reserve's powers, and the inception of federal deposit insurance. The period marked a transformative shift in attitudes toward monetary stability, with many beginning to see money less as an active agent in the economy and more as a passive element that could exacerbate downturns.

The Role of Money Supply and Velocity

The interplay between the money supply and its velocity underscored how a shrinking money stock compounded economic difficulties. This highlighted the significance of monetary policy in influencing overall economic health, reaffirming the need for a robust understanding of both money supply and demand.

Key Events of October 1929 and Subsequent Crises

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The stock market crash in October 1929 ignited a rapid economic decline. Panic set in regarding the stability of the banking system by 1930, leading to successive banking crises, where a diminished demand for deposits prompted a widespread shift toward currency, intensifying instability.

Impact of Bank Failures

The wave of bank failures played a pivotal role in the monetary collapse, directly correlating with the severe reduction in the money supply. These failures were not simply the result of inadequate banking practices, but rather significant contributors to the broader economic contraction.

Federal Reserve Responses and Policy Conflicts

Throughout the crisis, the Federal Reserve's response was marked by inconsistency, oscillating between tightening measures and attempts at monetary expansion. Internal disagreements among bank governors and external pressures hindered the institution's ability to implement coherent and effective policies.

International Influences

The global monetary landscape, defined by fixed exchange rates and a gold-exchange standard, exacerbated U.S. economic difficulties. The

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interconnectedness of international finance meant that a decline in U.S. economic activity reverberated across nations, contributing to a worldwide depression.

Conclusions on Monetary Policy Development

The events of this period crystallized the vital importance of sound monetary policy during economic downturns. The chapter illustrates the need for cohesive and decisive action from the Federal Reserve to avert further monetary destabilization in times of crisis. Through policy evolution and institutional reforms, the lessons of this tumultuous era emphasize the dire consequences that can arise from policy misalignment during economic tumult.

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Chapter 8: - New Deal Changes in the Banking Structure and Monetary Standard

Chapter 8: New Deal Changes in the Banking Structure and Monetary Standard

The New Deal era represents a pivotal point in American banking and monetary policies, characterized by significant structural changes despite a generally passive approach to monetary policy. The banking crisis of the early 1930s prompted urgent legislative responses aimed at stabilizing a collapsing financial system; hence, federal deposit insurance, revised powers for the Federal Reserve, and enhanced regulations for financial institutions were enacted. This period also saw experimentation with the monetary standard, notably involving a departure from gold to address the economic depression.

1. Changes in the Banking Structure

In the aftermath of the 1933 banking panic, three key legislative actions emerged:

1. Emergency Measures: These aimed to stabilize the banking system



and reopen closed banks.

2. Structural Reforms: The introduction of federal deposit insurance redefined the landscape of commercial banking.

3. Federal Reserve Adjustments: Amendments made to the Federal Reserve System modified its structure and increased its powers.

Emergency Measures

The Emergency Banking Act of March 1933 was a landmark piece of legislation that implemented several critical reforms:

- It established a nationwide bank holiday designed to stem the tide of bank failures.
- The Act allowed the President to intervene in banking transactions during emergencies.

This legislation facilitated the reopening of banks with impaired assets under close supervision, enabling conservators to manage withdrawals and initiate reorganization efforts. During this time, the issuance of Federal Reserve Bank notes helped bolster liquidity.

Opening of Banks

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Once the nationwide holiday lifted, licensed member banks resumed operations. However, the overall number of operational banks decreased, as many unlicensed institutions either ceased operations or were revitalized under new management, leading to significant changes in deposit levels.

Effect on Number and Deposits of Banks

Data shows a substantial reduction in active banks from nearly 17,800 in late 1932 to around 17,300 after the holiday. Bank deposits also plummeted as a direct consequence of the actions taken against unlicensed banks.

Fate of Unlicensed Banks

By mid-1933, over 2,300 banks had either reopened or closed, highlighting the varying deposit levels between reactivated banks and those that failed.

Effects on Money Stock Measures

The banking crisis resulted in inconsistencies in money stock statistics, complicating the analysis of monetary conditions due to the restrictions placed on unlicensed banks' deposits.

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Reform Measures Affecting the Banking Structure

The introduction of federal deposit insurance in 1933 was a revolutionary step that provided security for depositors, requiring banks to pay premiums for this insurance. Over time, the number of failures among insured banks decreased significantly, restoring public confidence in the banking system.

Other Changes

Additional reforms included modifications to banking membership rules, changes in interest on deposits, and imposed restrictions on commercial banks' investment activities.

Changes in the Structure and Powers of the Federal Reserve System

The Banking Act of 1935 brought profound changes to the Federal Reserve, consolidating power in the Board of Governors and altering monetary controls, including reserve requirements and lending policies.

Policies of Banks

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Banks in the New Deal era adopted a more cautious approach, focusing on liquidity. They increased their cash asset holdings and became wary of lending, influenced by their recent experiences during the financial crisis.

2. Changes in the Monetary Standard

Gold Policy

Under President Franklin D. Roosevelt, a managed gold standard was established, which required significant alterations to existing policies around gold. The government intervened heavily to raise commodity prices, banning gold hoarding, nationalizing gold holdings, and fixing the price of gold. This marked a shift that devalued the U.S. dollar and fostered an economic environment prioritizing price stability and increased domestic spending. The Gold Reserve Act formalized these changes, establishing a new monetary standard distinct from the previous gold-based system.

The Silver Purchase Program

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Roosevelt's administration also launched a Silver Purchase Program to support the price of silver by buying it at above-market prices. Despite acquiring large quantities of silver, the initiative's impact was limited, illustrating challenges within the broader economic context that resisted adaptation to such measures. Additionally, this policy had consequences

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Chapter 9 Summary: - Cyclical Changes, 1933-41

Chapter 9: Cyclical Changes, 1933-41

Overview of Economic Recovery Post-Depression

This chapter explores the dynamic economic recovery following the Great Depression, particularly from 1933 to 1937, characterized by a notable increase in the net national product. However, despite this robust growth, key indicators such as money supply and real income remained below pre-Depression levels, contributing to a noticeable economic contraction in 1937.

Changes in Money, Income, Prices, and Velocity

By 1937, although there were sharp increases in economic indicators, money income remained below the peak levels of 1929, signaling an incomplete recovery. This period was also marked by high unemployment rates and unequal income growth across sectors. Notably, the nondurable goods industry experienced significant production increases, highlighting disparities in economic recovery across different areas.

Government Policies and Their Impact

The chapter further examines the effects of government policies during this recovery phase, particularly the National Industrial Recovery Act. While



aimed at fostering economic growth, these policies inadvertently raised labor costs and introduced new taxes, negatively affecting private investment. Consequently, low business confidence emerged, dampening the overall economic landscape.

Interest Rates and Monetary Policy

An analysis of interest rates during this period reveals that long-term rates were on the decline; however, this was coupled with low demand for private capital and a substantial influx of gold, complicating the financial environment. Although the velocity of money increased, it did not reach the levels seen prior to 1929, illustrating the intricate relationship between the money supply and economic activity.

The Role of High-Powered Money

High-powered money saw rapid growth, primarily fueled by the influx of gold. However, fluctuations in the money stock relative to economic activity signified irregularities, suggesting that government policies and the broader economic context significantly shaped monetary conditions.

Federal Reserve Actions and Policy Environment

During this period, the Federal Reserve took a passive approach to monetary policy, failing to adequately adjust the high-powered money supply in response to evolving economic conditions. Coupled with increases in reserve requirements, this inaction contributed to the contraction experienced



between 1937 and 1938, leading to significant declines in economic activity.

The Importance of Monetary Factors

Ultimately, the chapter asserts that fluctuations in the money stock, driven by deliberate government actions, were instrumental in triggering and deepening the 1937 economic contraction. It emphasizes that true recovery only commenced once the money supply began to rise again, underscoring the critical role of monetary factors in economic stability.

Summary and Implications for Future Policy

In summary, this chapter highlights the intricate interplay between monetary policy and economic recovery. It underscores the lessons learned from the Federal Reserve's historical actions, illustrating the significance of effective monetary management as a tool for navigating future economic downturns and fostering sustained growth.



Chapter 10 Summary: - World War II Inflation, September 1939-August 1948

World War II Inflation: September 1939 - August 1948

The outbreak of World War II in 1939 ushered in a notable era of inflation in the United States, extending over a longer duration than during previous wars. By 1948, U.S. prices had more than doubled, influenced by a substantial increase in the money supply and income, coupled with a decline in the velocity of money—how quickly money circulates within the economy. Key statistics, including average annual changes in wholesale prices and the implicit price deflator, illustrated the economic fluctuations driven by wartime conditions.

1. U.S. Neutrality: September 1939 - November 1941

Initially, the U.S. maintained a stance of neutrality, witnessing limited economic repercussions from the war. By 1940, however, the economy shifted from a decline to a vigorous industrial boom, primarily as the nation began exporting war materials to allies. The increase in the money supply during this period was largely fuelled by gold reserves, reminiscent of World War I, though this time the Federal Reserve managed these inflows more



effectively. Price stability persisted until late 1940, when rising prices foreshadowed growing concerns regarding the expanding money supply.

2. Period of Wartime Deficits: December 1941 - January 1946

The U.S. entry into the war in December 1941 triggered unprecedented government spending, leading to significant cash deficits that peaked during the conflict—budget deficits reached nearly 30% of national income. In the immediate post-war period, government expenditures plummeted while tax revenues remained robust, resulting in improved fiscal balances. Inflation rates slowed during wartime, largely attributed to government-enforced price controls, which aimed to curtail rampant price increases.

Effects of Price Movements and Controls

Despite government interventions, price controls often led to hidden increases in actual prices, manifesting through product rationing and reductions in quality. The removal of these controls post-war catalyzed sharp inflation spikes, reflecting the pent-up inflationary pressures accumulated during the wartime period.

Velocity Behavior

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Between 1940 and 1942, the velocity of money surged but later experienced a sharp decline, closely linked to price controls and a scarcity of consumer goods. During this time, consumers preferred holding onto money, seeing it as a stable asset, which further slowed spending in relation to income.

Rise in Money Stock

The wartime expansion of the money supply was significantly driven by increased high-powered money derived from government security purchases rather than gold, marking a shift in financial dynamics from previous conflicts.

Government Financing Mechanisms

To fund war expenditures, the federal government relied on a combination of direct taxation, bond sales, and money creation. Most of the funding was acquired through explicit taxes; post-war surpluses facilitated a gradual reduction of public debts without triggering inflationary effects.

Effect of War Loan Drives

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War Loan drives resulted in fluctuations in the money supply as government bonds circulated among accounts. However, these drives did not substantially alter total currency levels, illustrating the intricate relationship between government financing and public deposit behavior.

Postwar Economic Environment: August 1945 - August 1948

In the aftermath of the war, economic activity experienced a rapid upswing despite concerns about unemployment. The demand for goods surged as government spending sharply declined, which consequently led to price increases. While the increase in the money stock was less significant compared to previous wars, public savings grew, fostering an expectation of deflation rather than inflation.

Conclusion on Price and Money Dynamics

Post-war inflation remained relatively contained, driven by public anticipation of potential price declines and significant government surpluses. This economic environment stood in stark contrast to the inflationary aftermath of World War I, showcasing how historical context influenced

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fiscal and monetary policy decisions.

In summary, this chapter presents a comprehensive analysis of the complex effects of World War II on U.S. inflation, examining the interrelation of government policy, public expectations, and structural changes within the economy during this pivotal period in history.

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Chapter 11 Summary: - Revival of Monetary Policy, 1948-60

Chapter 11: Revival of Monetary Policy, 1948-60

Overview of Economic Conditions

The period from 1948 to 1960 marked a significant era in U.S. economic history characterized by steady growth in the money supply, akin to earlier periods of stability. Despite this consistency, the economy experienced fluctuations in output and prices, indicating a more volatile landscape beneath the surface stability. The money supply's steady growth was noteworthy, showing less annual variability compared to previous stable eras, suggesting a cautious but optimistic approach to monetary management.

Monetary Policy Dynamics

During this time, the Federal Reserve faced considerable challenges, particularly exemplified by the inflationary pressures brought on by the Korean War. These challenges revealed a tension between the Federal Reserve and the Treasury, particularly around the Fed's commitment to supporting government securities while addressing inflation. This

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culminated in the significant Accord of March 1951, which redefined monetary policy frameworks, granting the Fed flexibility to adapt to emerging market conditions.

Behavior of Money, Income, Prices, and Velocity

The economic landscape shifted significantly during the minor contraction from 1948 to 1949, where both money stock and prices experienced mild declines. However, an increase in the velocity of money—a measure of how quickly money circulates in the economy—helped mitigate the adverse effects on income. Following this initial downturn, the post-war economy rebounded as public sentiment transitioned from concerns about deflation to fears of inflation, particularly influenced by the war's economic demands.

Korean War and Subsequent Policy Adjustments

The Korean War acted as a turning point, drastically altering economic expectations and fueling speculative behavior in the markets. The Federal Reserve's initial failure to control inflation sparked a reassessment of monetary policy, driven by rising government debt and interest rates. This led to a push for greater monetary control, as articulated in the Treasury-Federal Reserve Accord, which aimed for a tighter monetary stance to rein in inflationary tendencies.

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Post-Crisis Policy Responses

In response to the inflation triggered by the Korean War, the Fed shifted its focus to a more reactive stance in monetary policy. The Accord facilitated a strategy that moved away from unwavering support of government securities, allowing the Fed to more actively manage interest rates and stabilize prices. As the economy entered a recovery phase, the Fed remained vigilant about inflation while allowing money supply growth to align with overall economic expansion.

Shifts Towards Monetary Control

This chapter highlights a significant philosophical shift in monetary policy, emphasizing direct management of the money supply in tune with economic growth, rather than strictly adhering to credit availability. A focus on countercyclical measures emerged, aimed at controlling inflation and preventing deflation, which marked a new era in the Fed's strategic approach.

Bills Only Policy and Its Impact

Amidst the complexities of monetary management, the contentious "bills only" policy—limiting the Fed's trading to short-term securities—highlighted challenges in regulating interest rates and economic



growth. Ultimately, the Fed's decision to abandon this restrictive policy increased its ability to influence broader economic conditions, allowing it to respond more effectively to changing interest rates and market dynamics.

Concluding Thoughts on Monetary Stability

The chapter concludes by reflecting on the sustained stable growth rates of the money supply during 1948-60, linking this stability to improved data availability, enhanced confidence in monetary authority, and a growing public awareness of economic issues. However, as the decade progressed, early signs of volatility suggested an impending recalibration of monetary policies in response to complex economic realities.

In summary, this chapter outlines the evolution of U.S. monetary policy during a time fraught with both internal dynamics and external pressures, showcasing how government actions and public expectations played a pivotal role in shaping monetary outcomes and strategies.



Chapter 12: - The Postwar Rise in Velocity

Chapter 12: The Postwar Rise in Velocity

In the aftermath of World War II, the velocity of money—a measure of how quickly money circulates in the economy—experienced a remarkable increase, jumping from a historically low level of 1.16 in 1946 to a high of 1.69 by 1960. This surge stands in sharp contrast to the long-term decline in velocity that had been observed over the previous nine decades, indicating a significant shift in economic patterns.

Historical context showcases that this increase aligns with earlier trends of velocity fluctuations, particularly during the Great Depression and wartime periods, where both increases and sharp declines occurred. This historical backdrop suggests a cyclical nature in velocity, where increases often follow prior declines.

The rising velocity postwar can largely be attributed to the economic recovery that ensued after the war, characterized by an influx of liquidity resulting from pent-up consumer demand. Historical trends reveal that velocity tends to rise during periods of economic expansion and decline during contractions. However, the post-1946 period demonstrated some anomalies that diverged from these patterns, indicating a shift in behavioral



responses to income and prices.

This divergence suggests that the demand for money has become increasingly influenced by long-term expected income levels rather than solely current economic indicators. Several factors explain the postwar rise in velocity, including:

1. **Higher Returns on Alternative Assets:** As investments outside of traditional money offerings became more attractive, individuals were willing to sacrifice monetary liquidity for potentially greater returns.
2. **Access to Money Substitutes:** Institutional shifts, such as the proliferation of savings and loan shares, provided individuals with more alternatives to holding cash, thus reducing demand for money itself.
3. **Economic Stability Perceptions:** Increasing confidence in a stable economic environment diminished the perceived value of holding money for transactional purposes.

The relationship between interest rates and velocity also played a crucial role. While there's a correlation between rising interest rates and changes in velocity during the postwar period, the impact was less pronounced compared to previous historical trends, undermining the notion that interest rate fluctuations alone could account for these shifts.



Investigations into the relationship between money demand and price expectations yielded mixed results. While significant price variances in other countries demonstrated evident correlations, the U.S. showed muted responses due to smaller price fluctuations historically.

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Chapter 13 Summary: - A Summing Up

Chapter 13: A Summing Up

The monetary history of the United States since the Civil War reveals a intricate interplay of politics, international economics, and influential individual decisions. This chapter synthesizes over a century of monetary evolution with key insights into economic change, laying out several essential observations:

1. Changes in Money Stock: Variations in the money supply are significantly associated with economic activity, income levels, and overall pricing. Large increases in money stock often correlate with inflationary periods, particularly notable during 1914-1920 and 1939-1948 when wartime expenditures and recovery efforts influenced economic conditions.

2. Stability of Interrelations: Despite the tumultuous backdrop of periodic economic upheaval, the relationships between money stock and various economic variables have consistently demonstrated stability. Historical patterns can be observed in relative prices, particularly between the U.S. and Britain, and in the velocity of money—how quickly money circulates within the economy—across different time frames.



3. Independent Monetary Changes: Throughout history, monetary changes frequently arose independently from the prevailing economic activities. Events leading up to World War I show how the expansion of the money supply did not directly propel increases in income or prices, suggesting that monetary policy often plays a leading role in shaping economic conditions rather than merely reacting to them.

4. Deceptiveness of Appearances: The role of money in economic contexts can be misleading. While money serves as an essential medium for facilitating productivity, its value is derived from collective social agreements rather than any intrinsic worth. This reliance highlights the fragility of monetary systems, which may become vulnerable during periods of economic instability, reflecting a paradox at the core of monetary economics.

In conclusion, this chapter succinctly delineates the complex dynamics shaping U.S. monetary policy over the past century. It underscores the foundational principles influencing economic landscapes and emphasizes the critical importance of monetary policy in steering economic outcomes. Through these insights, readers gain a clearer understanding of how monetary factors perpetually interact with broader economic contexts, shaping the financial realities of the nation.

