

Comments on the “Recovery of 1933” (Jacobson, Leeper & Preston)

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Overview

- Explores reasons why the U.S. economy recovered from the Great Depression after 1933
- Emphasizes the effects of the devaluation from gold in 1933
- Standard views on recovery
 - Represents a regime shift that altered inflation expectations Temin and Wigmore (1990) and as tested by Eggertson (2008)
 - Going off gold stabilized allowed for reflationary monetary policy and help to stabilize the banking system (Bernanke, 1995) alongside other programs – RFC, FDIC

What's new in JLP?

- Conventional view on fiscal policy's role in recovery is that it was small and non-essential for recovery (Brown 1956, Romer 1992, Fishback 2010)
- This paper argues for a revision to that view:
 - When taken alongside the devaluation of 1933, subsequent “emergency spending” by the Roosevelt administration proved to generate strong fiscal-spending multipliers ($\sim 4 dY/dG$) because the fiscal expansion was “unbacked” (debt financed)
 - Ricardian equivalence broken in SR: policy doubled nominal debt over next 7 years without raising taxes
 - MP and fiscal policy are “equal partners” in recovery

Three parts to the research design

1. Theoretical motivation and modeling throughout
2. Historical narrative
 - FDR framed spending increases as temporary to and gold flows were not sterilized
3. 7-variable VAR and Variance Decomposition using monthly data (April 1933- June 1940)
 - Price level and GDP driven by fiscal expansion as our other variables in model
 - GDP recovery ensures debt/GDP does not explode

Provocative and interesting paper. Comments on fitting model to the data, mechanisms, and VARs

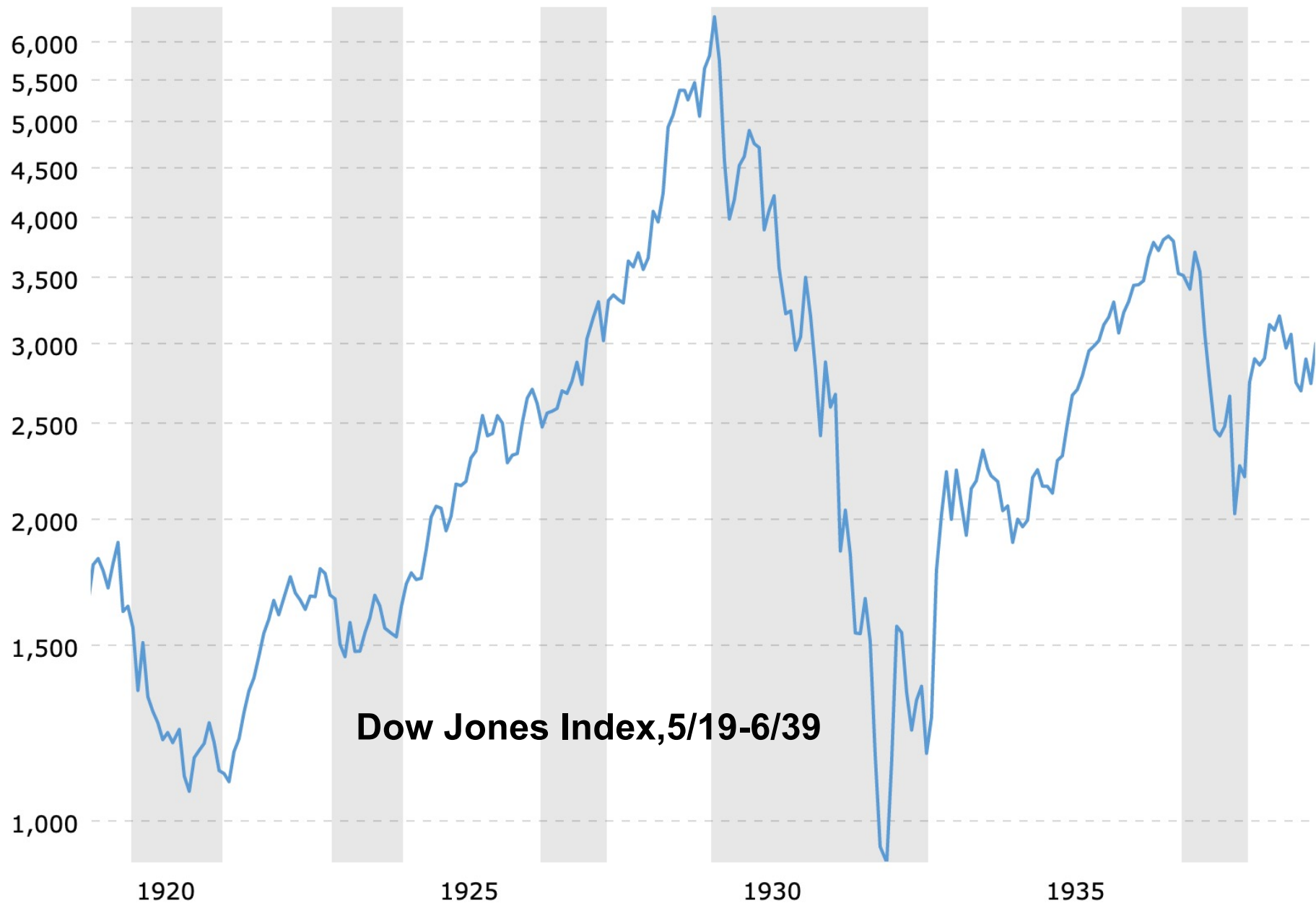
A quick summary of model's intuition

- Interest rates are “pegged.” Monetary authority not determining the price level.
- Who does?
- The “fiscal authority” determines the price level.
- Unbacked spending and transfers, alongside a devaluation, makes HH wealthier, inducing goods purchases and increasing in AD
 - Prices move in response.
- Key result: G-spending and transfers for unbacked expansion $>$ conventional Keynesian G-spending multipliers

1. Assets and Aggregate Demand

- Assumptions:
 1. Representative agent model
 2. Households hold wealth in bonds (and money)
 3. Bonds are held domestically
- “Bondholders convert higher wealth into higher AD” (p.6)
- What if we relax these assumptions to match the data?
- Who held bonds?
 - Top 0.1% of HH held 34% of all savings while 80% of Americans had no savings at all (Brookings, 1929). Liquidity constrained HH?
 - Private domestic households had limited access to long-term bonds during the 1920s and 1930s (Bordo and Sinha, JMCB forthcoming)
 - How do high mpc households substitute out of debt and buy goods and services?
- How much smaller are the effects with foreign bondholding?

2. What if HH held equities? 3.5X Returns



Dow Jones Index, 5/19-6/39

3. So where did the bonds go?

- During the period of analysis, banks doubled their holdings of cash and U.S. government securities relative to 1929 values.
 - High realized returns on G bonds up to April 1933
 - But negative and volatile returns thereafter (Fig.10)
- Can banks be put into your DSGE model?
 - Did large increase in nominal debt crowd out lending by banks?

4. Other mechanisms?

- Terms-of-trade effects on GDP & Prices
 - Expenditure shifting effects of devaluation: raises import prices & lowers export prices
- Is this channel for growth potentially independent of the temporary fiscal expansion as in Rodrik (2008) or an NK model like Dornbusch (1987)?
- Classic empirical paper: Eichengreen and Sachs (1985)
- More recent, Candia and Pedemonte (2021) estimate exchange-rate pass through using goods-level data and find U.S. cities more exposed to exchange-rate shocks experienced faster recovery

Could it be modeled or incorporated into VARs?

- Multi-country, open economy NK model of Bouscasse (2022)
 - Gold standard model with incomplete pass through & sticky wages for non-neutrality
 - Strength of expenditure switching depends on elasticity of substitution between domestic and foreign varieties, elasticity of subst of imported varieties, pass through of ex rate to int'l prices
- VAR set up is just one shock at beginning, so not an identification story
 - Staggered departures from gold (France, Belgium 1935) offer additional shocks to identify terms-of-trade effects

5. Data generating process

- VARs utilize monthly GDP and GDP deflator data that is generated from quarterly data (itself constructed ex post) using Chow and Lin (1971) procedure
 - Art is determining what series to include for interpolation. How to test if omissions meaningful?
- Ex: farm incomes and prices?
 - 10-30% of output decline from 1929-33
 - Warren and Pearson: reason to go off gold was to help farm prices
 - Devaluation raised farm prices and incomes, critical for 57% increase in IP in 1933 Hausman et al (2019)
- Retail sales as a monthly measure of consumption