WEE* ON THE DRY SIDE 252

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THE STOCK MARKET AND HISTORY

It is inevitable that the past week's stock market collapse should be compared with the collapse of 1929 which was only one of several heralds of the Great Depression. The comparison should be made; it may well be apposite. But the stock market collapse in 1929, except that it encouraged politicians to behave stupidly, DID NOT CAUSE the subsequent depression. The most profound understanding of the depression is to be found in politics rather than economics.

If a cataclysmic event can be said to have been caused by those decisions which, if taken differently, would have avoided it, then the depression was caused by trying to avoid adjustment to unavoidable changes in the real economy. When adjustment is delayed the amount of adjustment needed usually compounds.

During the twenties commodity prices fell greatly and comparative advantage in manufactured products shifted from the United States and Europe to Japan. To avoid adjustments, which would have meant temporarily-lower living standards, several nations borrowed more than they could comfortably repay, and others raised trade barriers against the newly efficient producers and enforced minimum wage laws. The minimum wage laws ensured that the industries facing the stiffest competition continued to decline; the trade barriers ensured that debtor countries could not get the currency to repay their debts; licensing, regulation and subsidy for old industries kept costs high preventing, new industries from developing; and the general economic malaise kept commodity prices low.

It was a vicious circle. Key markets had been prevented from adjusting, by laws and to a much lesser extent by trade union intransigence. In a sense the Great Depression was caused by market failure but in a much deeper sense it was caused by political failure.

No sensible economist claims that even the least regulated market is perfect. The imperfections will, among other things, cause the inevitable adjustments to changing circumstances to be uneven. However, we must ask whether governments are capable of improving the imperfect market, and if so, when. Government interference which delays rather than encourages adjustment to changes in the real economy is most unlikely to help anybody in the long run.

Markets work by quickly conveying masses of information about changing demand and supply in the m-th circumstance in the n-th locality. The mechanism is prices. Markets fail for other reasons too (externalities), but they certainly fail when the players are acting on misinformation, when prices are prevented from reacting to the available information, and when people are prevented from reacting to the prices.

The first question that must be asked is: can bureaucrats know about the m-th circumstance at the n-th location? If they can't, they will be acting on misinformation. The second question to ask the would-be regulator is: can he promulgate and police 'n' different regulations? The third is: can he change them 'm' times a day, week or whatever? One only has to pose the questions to know the answers. Political processes could not facilitate the necessary commercial adjustments even if that was what politicians set out to do. In fact, politicians always try to STOP events such as this week's price collapse and always delay economic adjustment and recovery.

The more an economy is affected by misinformation, rigid prices, or prevented reactions the more serious the consequences are likely to be. Plainly labour markets---controlled by union monopolies and minimum wage laws---are disasters trying to happen in any downturn, but so are the markets in traded goods.

If one started the week short it was a hell of a good week; if one started long it was just a hell of a week. But the gyrations of the stock market should not have untoward effects on the real markets----labour, goods and services. Personal fortunes will be made and lost in volatile markets but gains and losses, adjusted for inflation and opportunity cost, will cancel out across the market. Anyone interested primarily in future real living standards would ask only one question: is the stock market sending resources to where they will be best used? This person would not bother to ask who made fortunes and who went broke along the way. He would know that bankruptcy is the most humane process yet devised by which grossly over-valued resources are given a fresh start. During bankruptcy proceedings resources might lie idle, but even then the cost is less the more efficient are the relevant markets (in assets, workers' time and even lawyers). *Ad hoc* government intervention, as opposed to pre-established legal procedures, always slows down necessary realignments.

Let us hope this time that governments do not make the mistakes of the 1930s, when they prolonged adjustment to an overheated economy for so long it became The Great Depression. America had high trade barriers throughout the twenties but the year after the stock market collapse of 1929, the US Congress enacted even higher protection by the infamous Smoot-Hawley Act. President Hoover did not veto it.

During the twenties the United States tried to keep the world prosperous by issuing credit to finance foreign and domestic purchase of American goods. Worse, it issued the credit at artificially low interest rates encouraging investment in capital which could not service its cost at free market rates. The easy credit policy ended late in 1928. By 1930 much of this capital needed to have its value written down.

President Hoover took office in 1929. He tried to stop the business cycle. He contrived with business and unions to maintain real wages, cut taxes, pushed up government spending, budgeted a $2.2 billion deficit in 1931, subsidised farm produce and issued easy credit again. (He did these things long before Keynes published his '*General Theory*' in 1936.) At the same time Congress passed the Smoot-Hawley legislation. This spread the depression to the rest of the world and probably was a necessary condition for World War II.

Hegel once remarked that people and governments never learned anything from history. This time politicians should let the markets do their thing.

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