

Abstract: Why Money Matters: A Fourth Natural Experiment

Milton Friedman (J Econ Perspect 19(4):145–150, 2005; Wall St J November 17, 2006:A20) compared the behavior of money supply, nominal income and stock prices in the United States during the course of the 1920s and early 1930s with behavior in two other historical episodes, Japan in the 1980s and early 1990s and the United States in the 1990s and early 2000s. The three episodes, he argued, provided a natural experiment to test his and Anna J. Schwartz's explanation of the Great Depression of the 1930s. I use similar data for the U.S. recession that began in the fourth quarter of 2007 as a fourth such natural experiment. What makes this episode particularly interesting are the continuing comparisons between it and the Great Depression that have been made as events unfolded. The results are clear-cut. In the recent recession, like the U.S. recessions at the start of this century and the Japanese recession in the 1990s, there were no severe monetary shocks of the sort experienced in the 1930s. This recession, again like the other two, has been very much milder, and very likely will prove very much shorter than the Great Depression. This, in turn, is exactly what the Friedman and Schwartz hypothesis predicts.