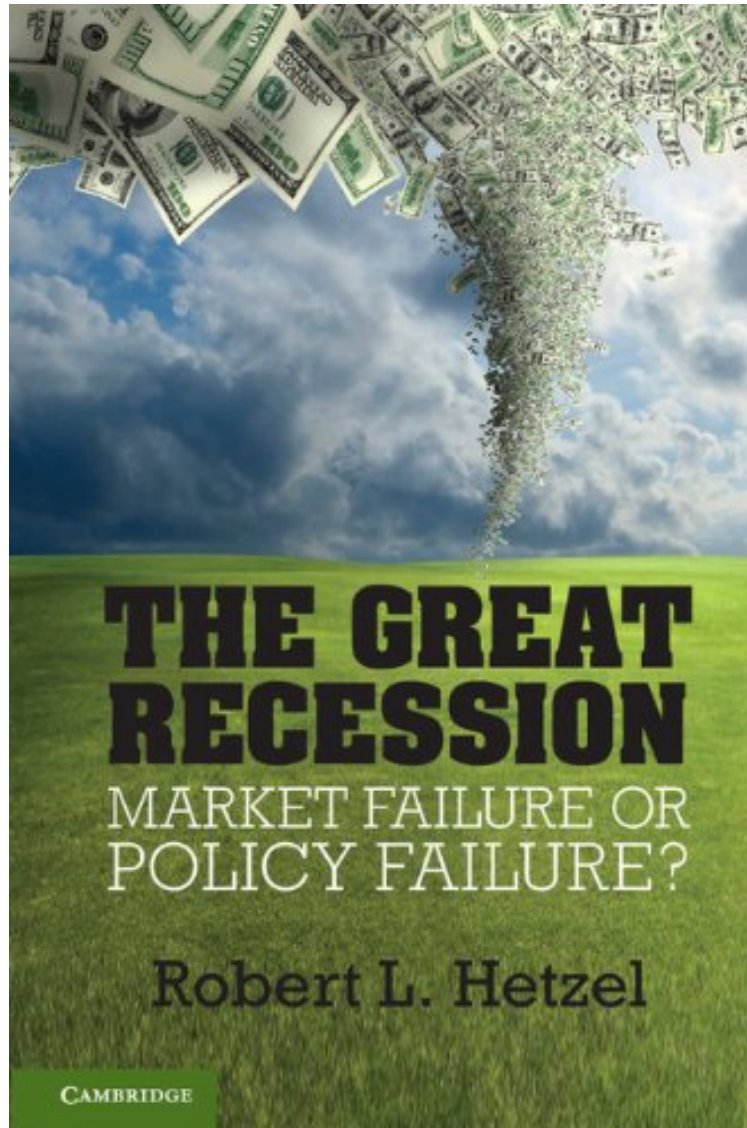


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The Great Recession (Studies in Macroeconomic History)

Robert L. Hetzel

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Robert L. Hetzel : The Great Recession (Studies in Macroeconomic History) before purchasing it in order to gage whether or not it would be worth my time, and all praised The Great Recession (Studies in Macroeconomic History):

10 of 10 people found the following review helpful. Interesting analysis of the recent recession By Hal Jordan Robert Hetzel, who is an economist at the Federal Reserve Bank of Richmond, has written a very interesting account of the 2007-2009 recession -- "The Great Recession." He argues that the Federal Reserve did too little during the beginning of the recession to keep what would have been a moderately severe recession from turning into a near catastrophe. Most people who make this argument focus on the Fed and the Treasury having failed to save Lehman Brothers from

bankruptcy in the fall of 2008. Hetzel, though, argues that the real failure came earlier in the year when the Fed, still concerned that rising oil prices might lead to significantly higher inflation, failed to reduce the target for the federal funds rate fast enough and failed to increase the rate of growth of the M2 measure of the money supply quickly enough. Hetzel argues that taking these measures during the spring and summer of 2008 would have headed off the sharp decline in the economy later in the year. I'm not sure I agree entirely with his argument, but he argues it well and anyone interested in monetary policy during the recession would profit from reading this book. I should add that the book contains relatively little technical analysis, which makes it quite readable for the average interested reader, although it may make Hetzel's argument appear less rigorous to other economists.

23 of 24 people found the following review helpful. Interesting insights

By George Hariton

While this book does not require any technical knowledge on the part of the reader, it is quite dense and not beach-side reading. The author advances a few hypotheses about the impact of the Fed's actions on the Great Recession of 2008-2009, and gives a wealth of evidence, mostly through carefully documented chronology of events, generally supporting his conclusions. This is in the style of Friedman and Schwarz, *A Monetary History of the United States*, and in effect updates that work up to about 2010. Fundamentally, Hetzel contrasts two basic hypotheses. First, this financial crisis (and financial crises more generally) are the result of "market disorder", i.e. there are external shocks that overwhelm the price system, i.e. the price system cannot adjust to them quickly enough to restore normal employment of people and capital. This comes in two flavors. Sub-hypothesis one is that easy credit causes bubbles in asset prices, which eventually burst, bringing prices crashing and causing recession/depression. The second sub-hypothesis is the Keynesian one. For psychological reasons, investor and entrepreneurs' confidence in the future falls -- their "animal spirits" suffer a decline, leading to a shortfall in aggregate demand and so causing recession/depression. The other basic hypothesis discussed by Hetzel is "monetary disorder", i.e. governments, through their central banks, interfere with the monetary system and stop market prices from re-establishing normal employment. At the level of the economy as a whole, this results from efforts to maintain interest rates (the price of consumption now rather than consumption in future years) at levels that are too low or too high. On this hypothesis, if only the central bank were to maintain a policy of providing just enough money to accommodate market forces, the price system would re-establish things and we would, at worst, suffer moderate recessions. Instead, in 2008-2009 the Fed maintained real interest rates at a level that was much too high, and this choked off incipient recovery and greatly aggravated the recession. The Fed did this (a) because it worried that otherwise inflationary expectations would take hold, resulting in actual inflation (b) to protect the value of the U.S. dollar on foreign exchange markets. (Yes, I know that worrying about inflation in 2008 seems strange, but Hetzel quotes convincingly from Fed members and Minutes of the FOMC. This documentation is Hetzel's great strength.)

Hetzel is quite critical of the Fed's bailout of financial institutions, and the resulting widening of the scope of the safety net, i.e. the government guaranteeing that creditors of both banks and non-bank financial institutions would not bear losses. This in turn created huge moral hazard -- banks could take undue risks because if the bets succeeded, the banks kept the profits, while if they failed, taxpayers would bear the losses. The bailouts meant that the Fed, not freely functioning markets, got to decide which financial institutions got to survive.

Hetzel also criticizes the Fed's "stop-go" policy of trying to use interest rates to pursue goals such as fine-tuning the economy, encouraging the housing market, and influencing the dollar's exchange rate. According to Hetzel, this creates uncertainty in the minds of investors and consumers and banks as to future credit conditions and inflation. This leads them to increase cash buffers and cut back on spending and loans.

Hetzel's voluminous evidence points to the "monetary disorder" hypothesis, i.e. the recession was made much worse by the Fed. Nevertheless he does not come to a final conclusion and leaves this as an open question. According to him, the Fed is still learning how to manage pure fiat money, which after all has only been around since the 1970s. All in all, a very informative read, but definitely not an easy one.

9 of 9 people found the following review helpful.

Explanations of the Great Recession

By John Wood

Hetzel describes his book as a horse race between two explanations of the Great Recession: market- and monetary-disorders. The former, preferred by Keynesians, views speculation and animal spirits as too much for the weak equilibrating tendencies of the price system. The latter sees recessions as due to monetary disturbances. The recent bail-outs and focus on credit and the structure of intermediaries were applied by policy-makers skeptical of markets and unaware of the history of business cycles. The monetary-rule lessons of the Great Moderation were forgotten by a Federal Reserve that learned the wrong lessons of the Great Depression. The book is rigorous but accessible, and full of the history of money and banking.

Since publication of Hetzel's *The Monetary Policy of the Federal Reserve* (Cambridge University Press, 2008), the intellectual consensus that had characterized macroeconomics has disappeared. That consensus emphasized efficient markets, rational expectations and the efficacy of the price system in assuring macroeconomic stability. The 2008-2009 recession not only destroyed the professional consensus about the kinds of models required to understand cyclical fluctuations but also revived the credit-cycle or asset-bubble explanations of recession that dominated thinking in the nineteenth century and the first half of the twentieth century. These 'market-disorder' views emphasize excessive risk taking in financial markets and the need for government regulation. The present book argues for the alternative 'monetary-disorder' view of recessions. A review of cyclical instability over the last two centuries places the 2008-

2009 recession in the monetary-disorder tradition, which focuses on the monetary instability created by central banks rather than on a boom-bust cycle in financial markets.