REVIEW OF *THE GREAT CRASH OF 1929: A RECONCILIATION OF THEORY AND EVIDENCE*, BY ALI KABIRI (Palgrave Macmillan, 256 pages)

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Does the world really need another book on the Great Depression? Ali Kabiri, lecturer in economics at the University of Buckingham, trudges into disputed territory but holds the reader´s attention by making three new contributions. First, he has collected new data on dividend yields and growth rates for U.S. common stocks during the 1920s to augment the plethora of existing price data. Second, Kabiri constructs a valuation model for the aviation industry of the time, which he roughly equates with modern technology stocks. Finally he uses the returns for a new investment vehicle, the closed-end fund, to illustrate actual investor returns free of any survival bias. Taken together, the three innovations allow the reader to come to grips with the financial side of the crash of 1929, instead of simply rehashing the more common macroeconomic side.

In explaining the correction in stock prices during 1930-32, Kabiri sees two factors as relevant: the fall in demand from the Great Depression and the banking crisis, which ultimately saw over 9,000 banks close their doors during the 1930s. Neither of these is especially controversial, and Kabiri does the reader a great disservice by not pushing his reasoning further. For example, by applying the logic of a basic dividend discount model, he sees the fall in stock prices as a rational (though unforeseeable) response to the decrease in earnings, and ultimately, dividends. It´s easy to blame the fall in earnings on the economic decline of the 1930s, but that only pushes the problem back one step. One cannot use the fall in demand from the Great Depression as a cause of the stock market

Procesos de Mercado: Revista Europea de Economía Política
Vol. XII, n.º 2, Otoño 2015, pp. 515 a 517

crash while also using the fall of stock prices as a cause of bank instability causing the Great Depression.

A more fruitful approach is found in Rothbard (1963), who uses Austrian Business Cycle Theory to explain why the boom of the 1920s sowed the seeds for the subsequent depression. Kabiri uses a similar approach as Rothbard by making use of the boom of the ´20s as the origin of the troubles later on. Unlike Rothbard, however, he does not place much emphasis on loose credit conditions or the Federal Reserve´s easy monetary policy. Despite reviewing the literature and commenting that «[r]esearch conducted at the time and more recently points to the large dislocations of the old monetary system of the world and the emergence of a more fragile one» (p. 71), he fails to integrate these findings in his own analysis. While discussing the change in the composition of debt from corporate to consumer, Kabiri remains mostly ambivalent on the effects, commenting that such a change «may have made the depression worse» (p.29). This approach overlooks the role that short-term economic growth, promoted by an inflationary monetary policy, had in inflating investor expectations about returns and thus propagating a stock market boom. The reader should not overlook the fact that at a discount rate of 7%, the P/E ratio of a stock would increase by 50% if dividend growth was expected to increase from 4 to 5%. Kabiri does not pursue the linkage between expectations, business conditions and monetary conditions, and this omission leaves the reader yearning for answers.

Kabiri gives the reader a unique financial perspective on the boom of the 1920s, but at the cost of not paying enough attention to the real economy. This is unfortunate, but no more so than most other books giving nearly exclusive attention to the real economy at the expense of the financial arena.

It is also unfortunate because Kabiri roots his analysis in a belief that markets are efficient, and that the stock market bust was mostly unforeseeable. Attention to the type of economic boom the country experienced during the 1920s would shed light on its ultimate unsustainability. More importantly, the link between rapidly changing expectations and share price changes are only properly analyzed, so it seems to this reviewer, during stock market declines (e.g., Black Monday 1987 has commonly been explained as a rational pricing response to an expected decline in the dividend growth rate). Kabiri missed a chance to apply the same logic the other way ´round. It is just as possible, indeed likely, that rapid increases in stock prices are a response to expected growth in earnings or dividends. At the end of the day, Kabiri gets half-way to the cause of stock market crash but that is not sufficient to convince this reviewer that he has all the answers.

REFERENCES

ROTHBARD, Murray N. (1963): *America's Great Depression*. Princeton, N.J.: D. Van Nostrand.