Comparing the Great Depression and the Global Crisis

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DEREK MCKENNA, MAY 1 2013

Compare and Contrast the Great Depression and the Global Crisis

The 1929 stock market crash and the subsequent 'Great Depression' was the biggest economic crisis that the world has experienced. The depth and length of the crisis and the suffering that it caused is legendary. Therefore, when the global financial crisis struck in 2007, many rushed to proclaim that we were about to experience another depression on a similar scale, or at least what some have termed a 'great recession'. This essay will compare and contrast the two economic crises to analyse the key similarities and differences between the two. To do this, the essay will firstly provide an outline of the conditions that led to the 1929 crash in the economy. Moving on from here, the essay will then look at the policy responses that were implemented to tackle the crisis before analysing the conditions that precipitated the 2007 financial crisis and the policy responses; it will draw out similarities and differences of each of the crises, and ascertain any lessons learned during the current global crisis from the policies of the Great Depression era. Finally, the essay will conclude with a discussion of the main points raised by the analysis of both crises and a look at the future prospects for recovery.

Capitalism is a system of economic development that has crises as an inherent feature. Many crises have occurred both before and after the 1929 stock market crash; however, the length and depth of the Great Depression has made it the point of reference for judging the severity of a financial crisis. Much debate has occurred over the causes of the Great Depression. While many see the late October 1929 New York stock market crash as the defining feature of the crisis, the reality was much more complex and multifaceted. As Teichova (1990, p.8) suggests, the Great Depression was "the deepest, all embracing (agricultural, industrial, financial, social and political) and longest crisis with catastrophic consequences". As well as this, although the United States led the way, this crisis was global and the rest of the world also experienced depression. So, any analysis of the Great Depression must look at the various factors that caused and perpetuated it.

The 1920s in America have been described as the 'Roaring Twenties'. After the devastation of the First World War, from 1920 to 1925, the US and international economies were experiencing a boom. During that period, world mining and manufacturing output grew by nearly twenty percent (McNally 2010, p.63). However, in terms of inequality, the poor were less poor but the rich were getting richer at a rate of four to one. As well as this, four-fifths of Americans had no savings, compared to twenty-four thousand families at the top who held a third of all savings combined (Canterbery 2011, p.13). During the boom, ninety percent of all Americans saw their incomes fall in relative terms (McNally 2010, p.64). A factor in this was an increase in union-busting and anti-labour laws, which increased income inequality. As well as this, agriculture, coal mining and textile industries were suffering from a post-war hangover which saw their profitability decline, and in many instances wiped out. This inequality, which concentrated wealth in so few hands, led to a huge increase in consumer credit, which in turn sparked off rising levels of private debt and a massive speculative bubble in the form of a property boom in Florida (Canterbery 2011, pp.13-14).

The mania of speculation was not confined to property, and between May 1924 and the end of 1925, there was a huge eighty-percent rise in stock prices. The trend continued and as Galbraith (2009, p.16) has suggested, "in early 1928, the nature of the boom changed. The mass escape into make believe, so much a part of the speculative orgy, started in earnest". During 1928, the Times Industrials (a pre-cursor to the DOW) gained a huge thirty-five percent, from two-hundred and forty-five points to three-hundred and thirty-one points. To maximise their gambling profits, many investors financed their purchase of stocks with borrowed money, with speculators buying one-thousand dollars of stock by putting down one-hundred dollars (Canterbery 2011, p.15). Of course, capitalism's bubbles must always burst, and this was no exception.

The US real economy was showing signs on a slowdown long before the stock market crash. However, on Wednesday October 23, 1929, a drop in the stock market lost four months of previous gains and the following day panic selling began. This was briefly halted by a meeting of the nation's biggest bankers who promised to pool their resources to halt the slide. Their efforts however were futile, and on 'Black Tuesday', October 29, the bottom fell out of the market, giving up all of the gains of the previous year (McNally 2010, p.65). Most economists agree that the Great Depression that ensued lasted for over ten years. Its economic impact was striking as GNP fell from a peak of $104.4 billion in mid-1929 to $56.6 billion in 1933. Its social impact was even more harrowing as twenty-five percent of the US civilian labour force was unemployed by 1933, the worst point of the depression (Canterbery 2011, p.18). There are a number of competing explanations as to why the crisis was so severe.

Explanations can be grouped into the two categories of monetarist and non-monetarist. For example, in a mixture of the two, Ben Bernanke (1983) suggests that there were three interlinked factors that propagated the Great Depression. The first was the failure of financial institutions, in particular commercial banks. The percentage of failing banks in 1930 was 5.6%, jumping to 12.9% in 1933, and this left a situation whereby in 1933 there were half the number of banks that had been operating in 1929 (Ibid, p.259). Bernanke goes on to cite defaults and bankruptcies as key, with the ratio of debt service to national income going from nine percent in 1929 to nearly twenty percent in 1933. This was pervasive across all sectors with home mortgages, farm mortgages, personal debtors and even state governments defaulting on their obligations (Ibid, p.260). However, key to Bernanke's view was the correlation of the financial crisis with macroeconomic factors. The crux of this view was that the financial crisis affected the macro-economy by reducing the quality of certain financial services, primarily credit intermediation (Ibid, p.263). In line with the monetarist view, it could also be argued that the Federal Reserve did not help matters. Its policy at the time was only to increase the credit base in line with requirements of trade, which essentially meant that as businesses were afraid to borrow, the Federal Reserve did not increase the money supply.

Somewhat similar to the monetarist elements of Bernanke's analysis is that of Friedman and Schwartz (1971,pp. 359-60) who argue that the crisis that originated in the United States was a domestic construct which was prolonged and deepened by a failed policy of failing to cut the discount rate, which meant a failure to provide credit and expand the currency. Kindleberger (1986a), taking a similar monetarist position but focusing more on international factors, suggests that the world depression stemmed from reparations and war debt, the overvaluation of the pound, the return to the gold standard in Britain and an undervalued French franc. These factors were aggravated by a fall in commodities and a rise in stocks in New York.

From a non-monetarist perspective, US government actions were no better, with the introduction of the Smoot-Hawley Tariff in mid-1930, sparking of a wave of protectionist tariffs around the world and a trade war which saw world trade figures nosedive (Canterbery 2011, p.19). The deflationary process was exacerbated by the huge levels of unemployment, which combined with other factors to initiate the 'multiplier/accelerator' interaction, reinforced by wage-cut enforced under-consumption as wages fell for manufacturing production workers by at least thirty-one percent between 1929 and 1933, as well as debt deflation and international interactions (Devine 1994, p.166). While this was happening, consumer prices only fell twenty percent during the 1929-33 period. This, as Devine points out, helps to explain that falling consumption was a major factor in the decline in GNP during this time, more so than previous or subsequent recessions (Ibid).

There are others such as Temin (1976) who suggests that monetarist explanations are wrong, and it was consumption and spending that declined first, therefore leading to a tightening of the money supply. Therefore, it was not monetary factors alone that caused the depression. Taking a different approach to explaining the depth and length of the depression, Kindleberger cites the lack of a lender of last resort as the major factor preventing any form of fast recovery (Kindleberger 1986b, p.4). This, he suggests, was due to Britain's inability after the First World War, and the United States' unwillingness to act in that regard. What each of these arguments above show is there is still no consensus on the policy responses that would have prevented such a deep depression from occurring. Such a lack of a consensus has also been a feature of the current global crisis.

Since the global financial crisis broke out, many have rushed to make comparisons between it and the Great Depression. However, before one makes these comparisons, an analysis of the fundamental differences in the nature of the capitalist system between now and then must be undertaken. After the World War boom in output and the post-war move to Keynesian economics, which essentially saved capitalism from self-implosion, the emergence of neoliberal capitalism in the latter 1970s in the form of Reaganism in the US and Thatcherism in Britain ushered in a new era of capitalist development that was distinctly different from its previous incarnations.

This period of capitalist modification saw the creation of the era of what Canterbury has termed 'casino capitalism' (Canterbery 2011, pp.83-121). He suggests that this era began with three powerful forces converging. These were: monetarism, which Milton Friedman advised Reagan would bring down inflation with minimal effect on employment or production; the influence of the 'neo-Austrians' who sought to reduce state influence over entrepreneurs through deregulation; and, finally, the pervasive idea that less taxes on the rich produced the trickle-down effect (Ibid, p.83). Reagan's policies during this era, continued under the Clinton administration, gave huge power over to Wall Street through deregulation, and contributed to a huge shift from production to financial services. As the financial sector grew its asset base, it became a much bigger part of the national economy. This can be seen in the fact that between 1978 and 2005, the financial sector grew from 3.5 percent to 5.9 percent of the US economy in GDP terms. To put this in perspective, from the 1930s to around 1980, the rate of growth for the financial sector was roughly the same as that of the non-financial sector. However, from 1980 to 2005, financial sector profits grew by eight-hundred percent, compared with two-hundred and fifty percent for the non-financial sector (Ibid, pp.116-117). This form of capitalism, where value and profit are not 'produced' but the result of speculation, is a form that gives huge power to unelected rating agencies and bankers to set the agenda, which even governments and international institutions find difficult to alter. It was under this system of capitalism that the global financial crisis emerged.

Many different arguments for the causes of the global crisis exist, and whilst it can be difficult to pin down the exact causality because of its global nature, there is agreement on a number of factors. Just like its sister crisis, the Great Depression, before the global crisis struck, the global economy went through a boom period with the world economy growing at a faster rate between 2001 and 2007 than in any other period in the past thirty years (Wade 2008, p.23). Most agree that the crisis was sparked by the subprime mortgage bubble collapse in the United States. However this spark was not the sole cause of the crisis. Just like the Great Depression, the factors that caused the crisis were numerous.

Although signs of an emerging crisis first appeared in 2006-7, it was not until 2008 when banks such as Lehman Brothers were going to the wall and financial assets were crashing that the full extent of the crisis was realised. As a result, flows of credit dried up and economies the world over started to suffer. However, this crisis was not solely a monetary crisis and had deeper dynamics at play: in particular, the financialisation of capitalism being built upon debts as a means of making profit (McNally 2010, p.86). The subprime mortgage crisis is illustrative of this. For example, in the year 2000, there was $130 billion of subprime lending in the US, backed up with $55 billion of mortgage bonds. Yet by 2005, those figures had jumped to $625 billion in subprime loans backed by $500 billion in securitised bonds (Ibid, p.103). The 'speculative orgy', as Galbraith termed it speaking on the 1929 crash, was back with a bang. What exacerbated the orgy more was the creating of innovative financial instruments in the form of credit default swaps (CDS) and other debt securities. For example, by 2006 the CDS on mortgage bonds was eight times the value of the bonds themselves, so when the crisis hit, that wealth was wiped out (Ibid, p.103).

The European context experienced similar problems as contagion spread throughout the world economy. Trade imbalances within the Eurozone created by the power of the German economy, in particular its exports, produced vast wealth within Germany, generating credit that was more than was required for domestic demand. The result was an outflow of cheap and easy credit to peripheral European states. This in turn with low interest rates created the basis for a speculative property bubble in places such as Ireland and Spain, and a rise in consumer debt across Europe (Avellaneda and Hardiman 2010, pp.4-5). This, coupled with the ECB having light regulatory practices and liquidity responsibilities, and the fact that the Euro project created an quasi-federal state with a centralised monetary and exchange rate policy but had no fiscal control over individual states, led to a disaster of structural design in the

Euro; this in turn prevented adequate policy responses from individual states, who instead were burdened with a one-size-fits-all, centralised Franco/German-led response.

It is clear that the immediate causes of the crisis were centred on "excessive debt leverage or imprudent lending" (Wade 2008, p.27). Much of this debt leveraging was in the form of the complexly structured credit securities, like the CDS, and when market panic set in following the collapse of Lehman, and this huge default risk pushed investors towards the tipping point. However, as Bernanke (2010) has pointed out, many factors were at play. Although the most prominent was the prospect of losses on the subprime market when the housing bubble burst, the system vulnerabilities as well as shortfalls in government responses explain the severity of the crisis. For example, the "sudden stop" in June 2007 of syndicated lending of asset backed securities to large borrowers. Other factors included the overreliance of banks on short-term wholesale funding, deficiencies in private sector risk management, an over-reliance on ratings agencies, excessive leverage on the part of households, businesses and financial firms, statutory gaps in regulation on special purpose vehicles and a failure of existing regulatory procedures worldwide (Bernanke 2010).

Although causality had similarities between the United States and Europe, the policy responses to deal with the crisis have been markedly different. Quite early into the crisis, perhaps learning from past mistakes from the Great Depression, the US government approved various Keynesian inspired fiscal stimuli and financial and auto sector bailouts: in particular, the Troubled Asset Relief Program (TARP), a $700 billion rescue fund for the banking sector which bought toxic loans at reduced rates (Nguyen and Enomoto 2011). This policy has been seen to be a relative success with an estimated final cost of $32 billion to the United States taxpayer (Congressional Budget Office 2012). In contrast to this, the European solution has been overwhelmingly austerity based, and the cost of the crisis being mainly burdened by the taxpayers of Europe. In particular, the Irish taxpayer's bill for the bailout of one bank, Anglo Irish, will cost the taxpayer more than the total final cost of the TARP program in the United States. In this regard, it does not seem that lessons from the Great Depression have been learned in a European context.

When we look to the rates of unemployment over the past number of years, it seems like the American policy of stimulus may be working slightly better than the European austerity agenda. For example, in the US, unemployment rose sharply after the onset of the financial crisis, going from 4.6 percent in 2007 to 7.2 percent in 2008, 9.3 percent in 2009 and 9.7 percent in 2010. However, in 2011 there has been a decline in unemployment to 9 percent (Index Mundi 2012). The European Union (twenty seven members) on the other hand has seen its unemployment rate grow from 8.3 percent in 2006, to 9 percent in 2009 and 9.7 percent in 2011 (United Nations Economic Commission for Europe 2012) to a current figure of 11.7 percent (Eurostat 2012).

So, how does the global crisis match up to the Great Depression? It is obvious that there are a number of similarities between the two crises. For example, with both crises there was an extended period of economic growth preceding the crashes. Each of the crisis periods also saw speculative bubbles based on the flow of easy credit which fuelled both property based and stock market excess. Both crises also saw staggering drops in industrial production and increases in unemployment. However, there are also key differences between the Great Depression and the global crisis. Primarily, the nature of the capitalist system has changed fundamentally from productive industrialisation to financial capitalisation. The policy responses of governments have also showed that lessons have been learned, especially in the American case, where Keynesianism and central bank intervention has been preferred to the Laissez-faire attitude during the Great Depression. In a European context, the decision to make taxpayers foot the bill for the losses of financial speculators marks a departure from the policies of the Great Depression where speculators suffered heavy losses.

There are, of course, other key differences between the two crises in-so-far as although initially the global crisis seemed every bit as bad, if not worse than the Great Depression, there are now signs that this may not be the case. For example, by measuring from the peaks in industrial production, the decline in industrial production in the nine month period from April 2008 was at least as severe as in the nine months following the June 1929 peak (Eichengreen and O'Rourke 2009). Similarly, in that initial nine month period, global stock markets were falling even faster than in the Great Depression and world trade was also falling much faster than in 1929-30 (Ibid). However the authors of this study have revised their analysis for 2012 and it paints an altogether different picture. The levels of industrial production had shown shoots of recovery over the past couple of years, but growth of global industrial output now appears to be slowing. The upturn had been promising, but this follows months when production was essentially stagnant. Notably in the Eurozone, industrial production declined (Eichengreen and O'Rourke 2012). Since initial early forecasts, global trade had showed signs of recovery, "but trade is now also fluctuating without direction, at levels barely higher than those of April 2008" (Ibid). As the authors also point out, while equity markets have recovered to a large degree compared with their initial drop, "it is worth observing that world equity markets remain considerably below pre-crisis levels" (Ibid). The somewhat gloomy outlook is confirmed by the latest United Nations 'World Economic Situation and Prospects' pre-release document which states:

Four years after the eruption of the global financial crisis, the world economy is still struggling to recover. During 2012, global economic growth has weakened further. A growing number of developed economies have fallen into a double-dip recession. Those in severe sovereign debt distress moved even deeper into recession, caught in the downward spiralling dynamics from high unemployment, weak aggregate demand compounded by fiscal austerity, high public debt burdens, and financial sector fragility (United Nations 2012, p.1).

So, although there are signs that the global crisis may not be as severe as the Great Depression, recent economic forecasts do not suggest that there will be a clear path to recovery in the near future. Capitalism has been proven to be susceptible to crises and cycles of boom and bust. The two cases here have been the most high profile of those crises. It does seem that some of the lessons of the Great Depression have been learned to reduce the severity of the global crisis. However, only time will tell if these lessons will ultimately stop a double-dip global recession and if lessons can be learned from the global crisis for the inevitable next financial crisis that will come down the line.

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Written by: Derek McKenna
Written at: Dublin City University
Written for: Dr. Michael Breen
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