The Great Lockdown vs. The Great Depression and the 2008 Global Financial Crisis

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The pandemic has unleashed an economic tornado. The global economy is paralysed to an extent that comparisons are being drawn with the 1930s Great Depression (GD) and the 2008 Great Financial Crisis (GFC). IMF has predicted global growth to fall to an unprecedented -3% in 2020, and unemployment is already breaking new records, hinting towards an abysmal recession in the coming months[1]. In fact, some believe the recession could overshoot the 'financial crisis' Great recession' and 'resemble the Great Depression of the 1930s'[2]. Although the scale of its consequences is eerily similar to the previous two crises, the impact of the current crises is much more different and daunting in some ways. One overarching difference is that the current turmoil is not rooted in any economic origins as compared to the GD and the GFC, both being endogenous shocks and products of long-term accumulated problems. Rather what makes it a bigger deal is its sudden eruption due to an unexpected public health crisis, enshrouded with uncertainty and leaving far-reaching, economic scars both in the **real economy** and **the financial sector** simultaneously.

Impact on the real economy

On the real economy side, the damages have been devastating and has the potential to become more monstrous than the Great Depression due to the pace and the scale of the economic impacts. This time we are facing an exogenous blockade on both the demand and the supply sides of the global economy which are the two fundamental components of capitalism. Whereas, as Richard Baldwin rightly points out, 'in normal recessions, the big problem is a lack of demand'[3]. Due to a subprime mortgage crisis and a loss in the household wealth, the 2007-08 financial crisis had resulted in a plunge in consumer spending, which 'affected the demand side first'[4]. Moreover, even in the event of the 1930s Great Depression, the stock market crash had burst the financial bubble which then drained the consumption and investment spending, leading to a contraction in the aggregate demand.

Globalisation as the culprit

To control the reach of the virus, countries are forced to undertake containment measures by cutting back on output and industrial activity, which has severe repercussions. Indeed, despite not having any economic origins, it is a *crisis of globalisation*. As Mike Davis argued in his book on the threat of avian flu in 2005, 'pandemics are a perfect example of the kind of crises to which global capitalism (with its constant movement of people and goods) is particularly vulnerable'[5]. Since things today are taking place in a much more globalised setting as opposed to the times of Great Depression in the 1920s and 30s, we are seeing the impacts to be much more immediate and turbulent.

The new globalisation era only began in the 70s, driven by deregulation, technological development, containerization and capital liberalisation etc as countries started to steer more towards neoliberalism[6]. In the 1990s, this subsequently resulted in a spurt in investments and the emergence of manufacturing hubs in other emerging, developing nations as well[7]. And thus, the world witnessed the advent of an entirely different era of value supply chain management where now different parts of a product started getting produced in different countries[8]. Though there was indeed a lot of financial movement especially from Europe to the US in late 1920s, which was also a partial factor in causing the depression, the supply chain system was still a lot localised. And during the GFC, it was indeed a spurt in the financial globalisation that led to the mortgage crisis in 2008. But there was still not an explicit disruption to the supply chains which we are witnessing today. On top of this, it is also important to note that it is only lately that we see a spectacular surge in China's contribution to the world economy. Even 'when the SARS virus hit in 2003', China's contribution was only about 4% of the world GDP[9]. 'Today, that figure is between 17-20 percent, making the origins of COVID-19 in China, all the more painful and damaging from an industry perspective'[10].

Disruption of global supply chains

As Tooze highlights, the three epicentres of 'production, exchange and corporate activity are the US, China and the Eurozone', and they are interconnected through 'flows of trade, organised through complex supply chains that span the globe'[11]. Thus, as these three centres and all other nations rigorously battle the pandemic and respond with stringent quarantine and containment efforts, we are seeing a significant disruption of supply chains which has worldwide ripple effects. According to a survey carried out by the Institute for Supply Chain Management, 'nearly 75 per cent of companies reported supply chain disruptions [in the production, procurement and distribution lines] …due to coronavirus-related transportation activities'[12]. The assembling of the subcomponents and the raw materials required to make the final product are today 'sourced from several places across the globe'[13]. Thus, even a single choke in this entire process automatically affects all the stakeholders involved in making the product across the world. Moreover, due to a reduction in travel and transportation, on top of the already 'dented global industrial activity', commodity prices have also collapsed which has hit producers even more harshly[14].

Impact on world trade

It is the first time we are seeing a contraction of production around the world since the second world war. Commodity exporters are amongst the worst affected[15]. About 90% of world trade that is transported happens through the maritime domain. But as 'border restrictions are getting tighter', ports getting closed and 'ship entries being restricted', the movement of goods and services is severely restricted[16]. Thus, the global shipping industry which 'is one of the root enablers of globalisation' is itself paralysed[17]. Such is the scale that the world trade is estimated to fall between 13%-32%[18]. If compared to the GFC, world trade flows were 15% below the previous year levels[19]. In addition, there is a sharp decline in the service sector as well that rely on human interaction due to social distancing measures, and they are indeed very much a product of globalisation. According to the IMF report, this mainly entails the 'hospitality, transport, retail, and entertainment service sectors' which 'account for 26% of GDP and employment of G20 countries'[20].

Demand-side shocks

In parallel to the supply-side shockwave, the real economy is also beholding a demand-side shock, which is ultimately also a creation of the punctured globalisation. As Strauss-Kahn notes, the supply shock has affected 'the financial sector and the demand side'. 'As a producer's constraint restrains the consumer, a demand shock emerges everywhere'[21]. As production takes a downturn, companies are likely to face closures and are already laying off workers to cut down on costs. Simultaneously, governments have also put stringent measures on movement of people which has drastically reduced the aggregate demand for goods and service. All of this has culminated into soaring unemployment all over the globe and thus a reduction in the purchasing power. Tooze predicts unemployment in America 'to reach 30% by the summer – greater than the Great Depression of the 1930s'[22]. About 22 million Americans have already filed for unemployment[23]. In comparison, even when the Great Depression had hit its lowest point by 1933, unemployment in the US still hovered around 20% of the population (about 15 million Americans)[24]. Whereas, only about 2.6 million people filed for unemployment in the US in the 2008 GFC[25]. In addition, global business confidence is also to take a serious dip and the 'scars left by reduced investment and bankruptcies may run more extensively through the economy'[26]. Therefore, due to the simultaneous demand and supply side shocks, aggravated by the extent of globalisation, the real economy would witness a much precarious global economic downfall of -3% – worse than the GFC (which was about 0.1% decline in 2009) and could be worse than the GD if the pandemic sticks for long[27] [28].

Impacts on the financial economy

Together with the deterioration of the real economy, there has been a sharp tightening of the global financial market conditions, adding fuel to the fire.

Corporate debt

In some sense, the financial sector is facing a similar crisis as it did during the GFC. The only difference is 'that the debt focus in the private sector is not on property and mortgage lending, but on loans to the corporate sector'[29]. The seeds of the crisis have already been sown with a brewing up of this debt since the GFC due to 'ultra-low and negative interest rates'[30]. By the end of December 2019, 'the global outstanding stock of non-financial corporate bonds' was double the level against December 2008, an all-time high of $13.5tn[31]. And thus, we are seeing financial institutions coming under the cloud yet again with a 'huge accumulation of corporate debt of increasingly poor quality' leading to asset-liability mismatches[32].

And Covid-19 has only exacerbated the financial crunch. As companies rushed to have more liquidity, it has put an 'upward pressure on borrowing costs', and with the rising unemployment, there is a widespread fear of more defaults, which is holding back lenders from extending credit[33]. As a result, with the real economy taking a hit, investors have become more risk averse. This caused the demand and thus the prices of shares and bonds to collapse together in March, which Tooze believes is something unprecedented[34]. By 23rd March, about $26tn has been 'wiped off the value of global equity markets'[35]. Therefore, with the bond and share market plunging, the foreign exchange market started to become more turbulent. All now people wanted 'to hold was cash, and what they wanted most of all were dollars' which came at the cost of depreciation of other currencies, while the dollar surged[36] [37].

Central banks as the last resort bastion

However, this damage caused by the economic shutdown accompanied by an immediate collapse of corporate credit could have gotten worse had the FED, the Bank of England and the ECB not intervened– the biggest learning from the 2008-09 GFC. Their intervention, such as through purchasing corporate debt and even government debt, has helped dilute the severity of the impact, at least for the time being. And as Tooze points out, 'what Europe and the US have succeeded in doing is to flatten the curve of financial panic' by maintaining 'the all-important flow of credit'[38]. If globalisation facilitated the damage to real economy, it is also the globalisation of finance which is helping us out today because in comparison to 2008 and the GD of course, we have a much better regulated financial system[39].

In order to pump investor confidence, assuage the corporate debt and meet the rising demands of the dollar, FED's role must be greatly appreciated. It cut interest rates to zero and extended liquidity swap lines to other central banks, something similar to what it did at the height of the GFC in 2008[40]. But what is unprecedented is that it widened the network of liquidity swap lines to cover 14 major economies to prevent the developing and the emerging economies from also submerging, as they have been severely affected both due to depreciation of their currencies and real economy taking a hit. This indeed indicates an immense level of coordination taking place between the major central banks. On the contrary, during the Great Depression, this kind of freedom and leverage was not available. As Eichengreen argued, 'gold-standard system hamstrung countries' and 'limited the ability of governments and central banks to respond' to the Great Depression[41]. But today, the FED can keep the global liquidity of dollars going as long as they want to stabilise the world economy[42]. In a nutshell, the central banks have 'intervened on a scale far greater even than in 2008' and in the GD[43]. In addition, it is also worth noting the unprecedented government fiscal response in affected countries. The US government itself announced a $2tn package which is 'twice the size of the stimulus bill passed in 2009'[44]. Whereas, during the Great Depression, there was in fact a cut in spending, which only made matters worse[45]. However, we are still falling short of a multilateral collaboration between countries as we saw during the GFC when the G20 took the lead. And the period 1920s and 30s is a proof of what can occur in the absence of cooperation or a hegemon, when no one assumes responsibility to stabilise the economy[46].

Therefore, in short, in comparison to the GD and the GFC, the impact of the current economic crisis on the real economy has been much hastier, more entrenched and very immediate as both the supply and the demand sides have been paralysed together, which only got aggravated by globalisation. Simultaneously, this crisis has radiated towards the financial sector due to the soaring corporate debt, which was in fact already getting accumulated since the GFC. However, despite the heavy toll on the real economy and the financial sector, there is still hope for faster recovery than we had during the GD and the GFC. Because, unlike the constraints faced during the GD like the gold standard, we are living under a much-nuanced financial system which has enabled the central banks and governments to play (especially the FED) a more potent role, much beyond than they played even during the GFC. But, multilateral collaboration between countries is still lacking, which is key to prevent the pandemic from leaving any long-lasting impressions on the global economy.

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Notes

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[39] Strauss-Kahn

[40] Tooze – “The Global Financial System”

[41] Eichengreen and Temin, pg 1-2

[42] Tooze – “Shockwave”

[43] Ibid

[44] Ibid

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[46] Kindleberger, pg 291

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