Investigaciones de Historia Económica - Economic History Research xxx (2014) xxx–xxx

Investigaciones de Historia Económica - Economic History Research

www.elsevier.es/ihe

Article

Great recessions compared

James Foreman-Peck

Cardiff Business School, Cardiff University, Cardiff, United Kingdom

ARTICLE INFO

Article history:
Received 16 July 2013
Accepted 7 March 2014
Available online xxx

JEL classification:
E52
E62
G21

Keywords:
Macroeconomic policy
Financial crises
Great depressions

ABSTRACT

Like the Great Depression of the 1930s, the current great recession triggered strong criticism of economists and economics. It is contended here that economists' majority opinion rightly recommended that, in the face of collapses of aggregate demand, countercyclical fiscal and monetary policies, built-in stabilisers and a regulatory system to maintain free trade were appropriate remedies. Economists may have under-estimated the stability of markets and the tightness of prudential regulation for reducing the severity of potential crises. But their assessments anyway are likely to be discounted if powerful industry lobbies judge they will constrain profits, rather than boost them. These propositions are developed in a comparison of the two Great Recessions in the United States, the United Kingdom, France and Germany.

© 2013 Asociación Española de Historia Económica. Published by Elsevier España, S.L. All rights reserved.

Grandes recesiones comparadas

Códigos JEL:
E52
E62
G21

Palabras clave:
Política macroeconómica
Crisis financieras
Grandes depresiones

RESUMEN

Como la Gran Depresión de los años 30, la actual gran recesión está siendo el blanco de muchas críticas por parte de economistas y financieros. En este artículo se afirma que la mayoría de las opiniones de los economistas señalaron, con razón, que los remedios adecuados ante quiebras de demanda agregada eran políticas fiscales y monetarias anticíclicas, estabilizadores integrados y un sistema reglamentario para mantener el libre comercio. Es posible que los economistas hayan subestimado la estabilidad de los mercados y la severidad de la regulación cautelar para reducir la gravedad de las crisis en potencia. De todos modos, sus valoraciones pueden ser descartadas si los poderosos lobbies industriales consideran que limitarán sus beneficios en lugar de incentivarlos. Estas propuestas se desarrollan utilizando una comparación de las 2 grandes recesiones en los Estados Unidos, el Reino Unido, Francia y Alemania.

© 2013 Asociación Española de Historia Económica. Publicado por Elsevier España, S.L. Todos los derechos reservados.

The Great Depression or its absence has been decisive in reformulations of macroeconomics in the last century. Keynes' General Theory and liquidity trap doctrine, together with the advocacy of fiscal policy, were a response to the sustained US slump after 1929. The apparent buoyancy of western market economies after the Second World War, and perhaps the effectiveness of activist macroeconomic policy, added plausibility to the monetarist counter-revolution with its emphasis on the primacy of monetary policy.

The 1987 US stock market crash, the Latin American debt crisis, the failure of Long Term Capital Management and the bursting of the dot com bubble were all absorbed without apparent lasting damage.[1] Some doubts did creep in; the stagnation of the Japanese economy from the 1990s and the East Asia crisis of 1997 raised questions about by-now conventional nostrums.[2] In particular Rajan's identification of the increasing importance and possible perverseness of finance management incentives in spreading the

E-mail address: foreman-peckj@cardiff.ac.uk

[1] Kobrak and Wilkins (2011).
[2] Krugman (1999, 2008), Saxonhouse and Stern (2003), and Eggertson and Woodford (2004).

http://dx.doi.org/10.1016/j.ihe.2014.03.009
1698-6989/© 2013 Asociación Española de Historia Económica. Published by Elsevier España, S.L. All rights reserved.

Please cite this article in press as: Foreman-Peck, J. Great recessions compared. Investigaciones de Historia Económica - Economic History Research (2014). http://dx.doi.org/10.1016/j.ihe.2014.03.009

risk of a meltdown in retrospect seems especially perceptive.[3] But it has been the severity and duration of the present world recession that precipitated the biggest wave of criticism (inter alia from Her Britannic Majesty[4]) of the inadequacies of economics and economists, supposedly responsible for prevention and cure.

The contention here is that in important respects such concerns are misplaced. Actually, the long run influence of the economics profession – insofar as they carry weight with policy makers – has probably been fundamental in alleviating what might have been, and might still be, an economic crisis worse than that of the 1930s. Financial crises, albeit on a smaller scale, have been a regular feature of private enterprise economies – in nineteenth century Britain they occurred approximately every decade; their timing is hard to predict but they seem to be intrinsic to dynamic market economies.

Techniques of financial innovation and malpractice have become more complex since the period between the World Wars, and globalisation now more closely links national financial networks and economic activity more generally. Hence, the US in 1929 is the model for the more widespread financial crisis of 2008; from this we may infer that without the central bank and government interventions in the later recession, the crisis would have been as severe as in the 1930s' United States. The comparatively small fall in outputs in the recent recession then must be attributable to the counter-cyclical monetary and fiscal policies implemented from 2008, ultimately inspired by economists, along with the built-in stabilisation of government budgets. True, the possibility, or the susceptibility to policy remedies, of massive aggregate demand collapses was denied by sections of the economics profession, but clearly they were not influential when the recent crisis arrived.

The less resolved difficulty has been that, as society evolves, core economic problems change and learning lessons from what has not gone wrong is more challenging than appreciating the reasons for disasters. The staid British and French financial systems of the late 1920s proved robust to the collapse of the speculative frenzy in the United States. Subsequently they converged on the deregulated US model of the 1920s, the defects of which US policy makers of the 1930s had attempted to remedy.

While economists may not be counted on to predict the timing of crises, they might be expected to offer guidance on arrangements to reduce their severity. Of course it is entirely possible that such guidance if offered will be ignored unless it conforms to the interests of the most powerful lobbyists. The outgoing Governor of the Bank of England in 2013 condemned Britain's banks for putting tremendous pressure on politicians 'at the highest level' to reduce the required strengthening of their balance sheets.[5] But a broad stream of economics has emphasised effectiveness of competition in free unregulated markets, with firms maximising shareholder value, for creating a stable and steadily growing economy. The Washington consensus underestimated the scope of financial innovation for creating speculative bubbles, while lacking appreciation of the magnitude of the international shock from allowing large financial institutions to fail. Consequences were the dismantling in the US of regulatory structures put in place in the 1930s and the deregulation of finance in Britain and France in recent years. With hindsight this looks to have been excessively sanguine.

A major non-event of the current recession is the collapse of world trade. In the earlier crisis a welter of restrictions and prohibitions on imports caused great hardship and precipitated extremist political changes – Japan and Argentina are just two examples. Economists generally preach the virtues of free trade; they supported the General Agreement on Tariffs and Trade and then the World Trade Organisation, both of which were established to avoid another international debacle like that of the 1930s. Trade during the present Great Recession testifies to their success.

The remainder of this paper substantiates these points. The following Section 1 explains the patterns of output over the two Great Recessions in the US, the UK, France and Germany. Then the onsets of the two depressions are compared to show the role of financial crises with their contrasting initial impacts in the two periods. Section 3 outlines the second debt and liquidity crisis phase of both recessions, accounting for their duration, at least in Europe. The paper then considers the policies implemented or their absence in both periods, beginning in Section 4 with monetary policy and fiscal policy in Section 5. Section 6 considers prudential re-regulation after each crisis. Then Section 7 discusses labour markets, wages and unemployment in the two slumps in the light of Real Business Cycle Theory. The two slumps in the international sphere are the subject of Section 8.

1. Output in the two great recessions

The first notable point of comparison is that paths of output differed markedly between economies in the two recessions. Business cycle measurers generally prefer quarterly series of output, but until recently most historical reconstruction – on which we are dependent for the Great Depression series – has been restricted to annual data. In the present exercise we construct quarterly series for the four economies of interest using monthly output data created in earlier research.[6] A recession, depression or economic crisis is measured by the magnitude of the initial contraction of economic activity and the time taken to recover the previous peak. Higher frequency output series appear to give greater peak to trough falls in the great recessions.

Fig. 1 begins in 1927 to emphasise the fragility of the interwar economies before the collapse, which contrasts with the apparent robustness of the economies leading up to the 2008 recession (Fig. 2). In the first recession German output peaks earlier than others, and both Germany and the US experience small dips before the major downturn in 1929. Comparing the course of quarterly real output for the three largest European economies, France, Germany and the UK, and for the United States, the two recessions show more similar experiences in the 2008 than in the 1929 depressions, thanks to globalisation.

Output collapsed much less in the more recent crisis generally, either because of the nature of the shocks or because of more active or effective policy. The relative positions of the economies have been reversed in the current recession, in that the US and Germany are emerging more strongly whereas in the earlier depression their two troughs were proportionately the deepest. Certainly in the present recession Germany suffered a severe dip, but the economy recovered very strongly and quickly.

In the Great Depression the US experienced the deepest peak-trough fall. The greatest victim of the four in the recent collapse is the UK and the duration of the recession promises to be longer than that of the United States. Yet the proportionate fall of UK GDP to the trough of output in the interwar depression was easily the

[3] Rajan (2005).

[4] On a visit to the London School of Economics in 2008, the Queen Elizabeth II of England, expressed surprise at the apparent failure of the economics profession to predict the financial crisis and the Great Recession.

[5] Rowley (2013).

[6] In a series of papers beginning with Foreman-Peck et al. (1992). The monthly series are available at http://business.cardiff.ac.uk/welsh-institute-research-economic-development, under 'data', and the quarterly indices are in the appendix to the present paper. The correlation between the level of the monthly UK GDP index underlying the quarterly UK index and both of the more recent monthly UK GDP series between 1927 and 1936 is 0.967 (Mitchell et al., 2012).

Download English Version:

https://daneshyari.com/en/article/1159569

Download Persian Version:

https://daneshyari.com/article/1159569

Daneshyari.com