



## Recession or Depression? Part II

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In an earlier essay, I argued that recent data and forecasts published by the Blue Chip Consensus and the Survey of Professional Forecasters suggested that it is highly likely that the recession that began in December 2007 would be both the longest and the deepest recession in the post-World War II period. Although the current contraction in economic activity is projected to be dramatically less severe than that seen during the 1930s (it remains to be seen when the current recession will end), a casual reading of the popular press still suggests that many commentators believe that the current recession bears many similarities with the Great Depression. The purpose of this follow-up essay is to look at other indicators, including monetary and fiscal policy actions, to see whether the parallels between today's recession and the 1930s Depression are real or more imagined.

As the accompanying [table](#) shows, the economic performance during the current recession is sharply different from the 1929-33 episode in most key respects, but not in all respects. As reported in Part I, the actual and projected decline in real GDP (-2.8 percent) and the rise in the unemployment rate (4.6 percentage points) in the current recession is significantly smaller than that seen in 1929-33 (-26.5 percent and 24.6 percentage points, respectively). Nevertheless, given the collapse in the housing market, the subsequent disruption in financial markets, and the difficulties experienced by the banking system, there has been considerable economic distress. These conditions, as with the general global nature of the recession, also occurred in the 1929-33 episode. Unlike today, though, larger banks during the 1930s were in better financial shape than smaller banks. Accordingly, the banking crises of the 1930s reflected runs on deposits of small banks, which caused massive failure without deposit insurance.

The upper part of the table provides comparisons of several key economic indicators not examined in Part I, while the lower part compares and contrasts the responses from monetary and fiscal policymakers. The upper half of the table shows that the major price indices and measures of nominal wages and compensation posted double-digit

declines during the 1929-33 period. By contrast, in the current recession, prices and wages have increased, albeit at fairly modest rates. One similarity between the two periods is the sharp decline in nominal house prices—about 25 percent according to measures produced by Yale Professor Robert Shiller. Other comparisons between the two episodes are less exact. It has been estimated that as many as half of all residential mortgages as of January 1, 1934, were seriously delinquent. Today, as of December 2008, only 3 percent of residential fixed-rate mortgages were seriously delinquent (90 days or more past due). Admittedly, today delinquency rates on subprime mortgages are much higher than on conventional mortgages.<sup>1</sup>

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Many economists have argued that economic conditions during the Great Depression were worsened immensely by the Tariff Act of 1930, otherwise known as Smoot-Hawley. This Act sharply raised tariffs on over 20,000 goods imported into the United States and helped contribute to a nearly 50 percent decline in U.S. exports and a roughly 66 percent decline in global trade. While Congress and the Administration have not repeated this policy mistake, recent opinion polls show that public support for free trade has nonetheless waned. Accordingly, policymakers have adopted initiatives that have raised concerns among numerous foreign economic policymakers. These include the “Buy American” provision in the American Recovery and Reinvestment Act of 2009 (the “Economic Stimulus”) and the decision to cancel a pilot program that allows Mexican-owned trucks to operate in the United States. Mexico imposed tariffs on certain U.S. products in retaliation. Although the World Trade Organization forecasts a decline in global trade in 2009 for the first time since World War II, they attributed

this mostly to a collapse in global demand rather than to rising protectionism.

Financial and banking conditions were dire during the 1930s, as more than 9,700 banks failed or suspended activities from 1929 to 1933.<sup>2</sup> These failures and their associated bank runs led to a national banking holiday, followed by a significantly more intrusive regulatory oversight of the banking system. Perhaps because of these reforms—importantly, deposit insurance—and the policy lessons learned during this period, there have been fewer than 50 bank failures since the beginning of 2008. Finally, although the stock market (S&P 500) declined by more than 56 percent between October 9, 2007, and March 5, 2009, the stock market decline was much larger during the Depression: Stock prices fell by 85 percent from September 1929 to June 1932 (monthly averages).

Interestingly, there are two more similarities between the 2007-09 and the 1929-33 episodes: the responses by monetary and fiscal policymakers. In 1932, section 13(3) was added to the Federal Reserve Act, which allowed the Fed to engage in (what is now called) unconventional policy. However, actions taken during the current recession have been much more aggressive than those implemented during the 1930s. In the current episode, the Federal Reserve has used section 13(3) to enact several special lending programs. These programs have greatly enlarged the Fed's balance sheet and led to a dramatic escalation in the St. Louis adjusted monetary base to more than \$1.6 trillion as of March 2009. In March 2009, the FOMC announced several new initiatives that could conceivably more than double the monetary base. These actions include the first widescale, non-sterilized purchases of Treasury securities in several decades.<sup>3</sup> Admittedly, today's policy appears heartening when one considers that monetary policymakers pursued a mostly contractionary policy in the early 1930s: From August 1929 to October 1930, the FOMC actually allowed the monetary base to fall by 4.5 percent; and from October 1929 to March 1933, it failed to prevent the M1 measure of the money supply from falling by about one-third.

Fiscal policy has also been more expansionary in the current recession than during the early 1930s. According to Council of Economic Advisers Chairman Christina Romer,

the largest fiscal expansion of the New Deal occurred in 1934, when the fiscal stimulus totaled 1.5 percent of GDP.<sup>4</sup> In February 2009, Congress passed and the Administration signed a \$787 billion fiscal stimulus legislation. According to the Congressional Budget Office (CBO), 91 percent of the net impact on the unified budget will occur over fiscal years 2009-11, which amounts to a projected average of 1.6 percent of GDP over this three-year period.<sup>5</sup> The Administration also plans dramatic increases in government spending beyond the fiscal stimulus. According to CBO estimates, the budget deficit will total nearly \$1.9 trillion in 2009 and another \$1.4 trillion in fiscal year 2010. Together these deficits amount to an average of slightly more than 11 percent of GDP—easily the largest budget deficits since World War II.

On balance, then, the monetary and fiscal response during the current recession has been more aggressive than that seen during the Great Depression, even though, by most economic indicators, the current recession pales in comparison with the Great Depression. ■

### Further Reading

Brown, E. Cary. "Fiscal Policy in the Thirties: A Reappraisal." *American Economic Review*, December 1956, 46(5), pp. 857-79.

Fettig, David. "The History of a Powerful Paragraph." Federal Reserve Bank of Minneapolis *The Region*, June 2008.

Parker, Randall E., ed. *The Economics of the Great Depression*. Northampton, MA: Edward Elgar, 2007.

Wheelock, David C. *The Strategy and Consistency of Federal Reserve Monetary Policy 1924-1933*. Cambridge: Cambridge University Press, 1991.

<sup>1</sup> In December 2008, 32 percent of variable-rate subprime mortgages were seriously delinquent, while 13 percent of fixed-rate subprime mortgages were seriously delinquent.

<sup>2</sup> Some of these suspended banks eventually failed, or they later re-opened or were merged with other, healthier banks.

<sup>3</sup> See [www.federalreserve.gov/newsevents/press/monetary/20090318a.htm](http://www.federalreserve.gov/newsevents/press/monetary/20090318a.htm).

<sup>4</sup> See [www.whitehouse.gov/administration/eop/cea/speeches\\_testimony/03032009](http://www.whitehouse.gov/administration/eop/cea/speeches_testimony/03032009). This view perhaps glosses over how to measure the influence of fiscal policy on aggregate demand and whether fiscal policy was effective in boosting aggregate demand in the 1930s. See Brown (1956).

<sup>5</sup> The fiscal stimulus is 1.3 percent of GDP in 2009, 2.7 percent in 2010, and 0.9 percent in 2011.