A Historical Comparison on Great Recession and Great Depression: From Economic Point of View

Aiperi Ismailova
Johnathan Ives
Miles Kinnamont
Layla Lee

Introduction

The economy of the country is not always stable, being affected by different political, social and cultural structures, the components and variables of the economy change. However, in the long run, the economy is usually following kind of a stable process, which is called business cycle. This process is based on the fluctuations changing each other in a time. The economic growth is usually followed by increased production, good economic stability, low level of unemployment, stable prices and so on, while the time of economic decline is characterized by decreased economic activities, decreased production, high inflation and unemployment rates and crises. According to business cycle this two processes are changing each other, what means that there cannot be always just economic growth, there is always a contraction before each expansion.

In history of the United States, there were two very big economic contractions: The Great Recession and The Great Depression. This two crises had a huge effect not only on the economy of the United States, but on the world's economy. The Great Depression in 1929-1933 was created because of the collapse of the stock market, when people invested a lot of money to the banks buying the stocks, but later banks were unable to repay all money invested and this failure of banks lead to the decreased investment, because people were afraid of investing their money due to the huge level of risk. The Great Recession of 2008 can be characterized by the same scenario, when people were buying houses with subprime mortgages, but due to the big demand for houses the price felt down and people did not want to pay the initial price which was higher, what lead to the collapse of housing market. We will describe more specifically these two economic crises in our paper, however even the general information proves that there can be made a parallel between these two economic declines, and we can find a lot of differences and similarities.

In this paper we would like first to determine the causes of the Great Depression and Great Recession. Looking for the similarities in the causes we will analyze the similar consequences on the economic

activities, such as the decrease in consumption. Second, we will work on determining the effect of the economic crises on GDP, unemployment and inflation rates. Both, depression and recession, decreased the economic activities what lead to increased level of unemployment and inflation and reduced GDP, however we will try to measure the proportions and compare which economic crisis had bigger expansions. And the last, we will analyze the policies, which were made by government in solving these contractions and improving economic stabilities. Working on this paper, we believe that our researches will help us not only make a parallel between the Great Depression and Great Recession, but also understand the structure of business cycle, which determines the predictions in economic development of the countries.

1. **The economic cause of the Great Depression (October 1929) and Great Recession (December 2007).**

The causes of the great depression and great recession parallel in nature. The three pivotal causes of these financial crises can be seen in market crashes, the failure of banks, and reduction of purchasing across the board.

The Great Depression

There have been a multitude of crashes in U.S history, but none rival the devastation and terror of the crash of the stock market that occurred on black Tuesday, October 29, 1929. Between the time period of 1924 and 1929 the Dow Jones Industrial average quadrupled, at the time the longest bull market ever recorded (Suddath). The exuberance of the market began to draw investors into the market investing on margin with borrowed money. During this time 40% of bank loans were used in order to purchase stock (Suddath). The peak of the stock market occurred on September 3, 1929 when regardless of several bank failures, the Dow Jones Industrial average was 381.17, 27% higher than the previous year (Wattenberg).

Stock Market Crash

On October 23rd, 1929 the prices of stocks suddenly plummeted in the last hour of trading.While the market was closed, the time allowed for investors to fall into a crazed panic. On October 28th, also referred to Black Monday the Dow Jones Industrial Average had dropped 13% as seen in Figure 1.

Figure 1

Figure 1 displays the eventual market loss in 1932, alothough investors could have regained a portion of their losses from dividends, the Dow Jones Industrial Average did not return to the high seen in 1929 until 1954. The following day, Black Tuesday, three million stocks were exchanged within the first thirty minutes of opening. Brokers called in margins, if the stock holder was unable to pay; their stocks were sold, resulting in many investors' lifesavings to be wiped out completely. By the end of the day 14.6 million shares of stock total exchanged hands, the highest daily quantity of stocks exchanged at that point in time, as frighten investors attempted to soften the blow of the declining stocks they possessed. (Wattenberg).

The sharp decline had a strong effect on the economy. Demand for goods declined due to the effects that the stock market financially had on households that had invested in stocks. Future investment struggled to be financed through stock due to the stigma associated with owning stock.

Bank Failures

Though the individuals that purchased stocks were greatly affected, the segment that quite possibly was most effected was the banking sector. Between 1929 and 1933 9,000 banks suspended operations due to financial distress as seen in figure 2.

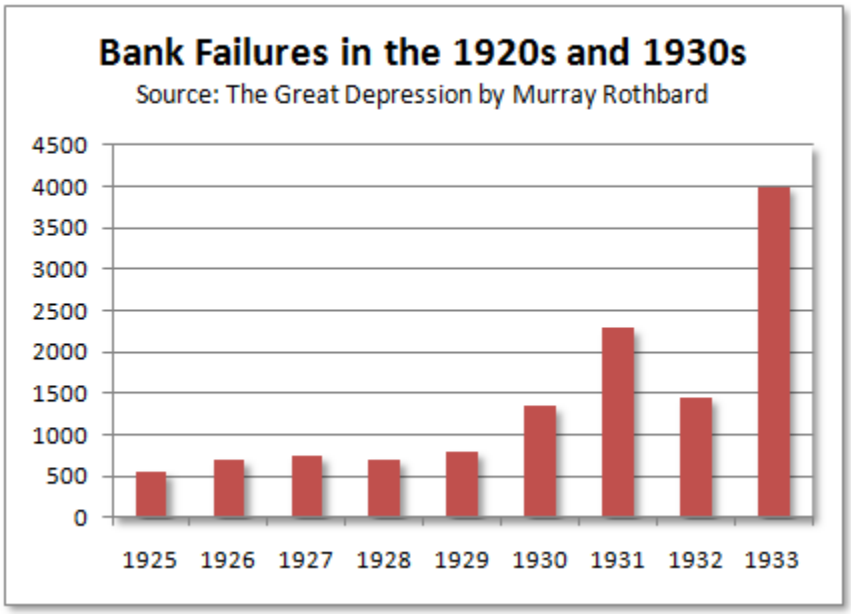


Figure 2

Some economists blame the banking panics that occurred in 1930 for decreasing money supply drastically, in turn causing economic activity to decline (Milton, Jacobson 222). However an opposing view contends that the bank failures occurred in consequence of the sharp decline of national income (Milton, Jacobson 223). Much of the economic analysis of the Great depression is from a macroeconomic perspective with lesser focus on the regulations on the market. Some theory on the failure of the banking sector is focused on the parallel between the bank failures in the Great Depression and those of the 1920's, linked to a decline in agricultural income; However other studies show that the bank failures were independent of the agricultural segment (Milton, Jacobson 225).

25 billion dollars, in today's dollars 319 billion was lost in the 1929 stock market crash. Although October 29th, 1929 proved to be detrimental to the United States, the stocks continued to fall until they

eventually bottomed out November 13, 1929, then fell once again as the Great Depression began (Suddath).

Decline of Consumer Spending

The stock market crash caused a collapse in durable goods spending as well as non-durable goods spending in the 1930's. Income uncertainty peaked in September of 1930 during the gold standards crisis, which decreased consumer spending further. The decrease in consumer spending was also coupled by the high unemployement rates that occurred during the 1929 to 1933 period. The changes in consumer spending from 1928 to 1933 can be seen in figure 3 below, a 80.68% decrease in consumer spending from 1928-1933.

	Perishables	Semi-durables	Durables	Services	total
1928	164.3	59.9	38.4	269.6	532.3
1929	168.3	61.7	40.3	284.4	554.8
1930	164.8	56.1	30.9	269	520.8
1931	164.4	53.6	26.4	257.6	501.9
1932	154.1	46.9	20	236	456.9
1933	151.1	42.7	20.2	233.5	447.6
Decrease (1929 to 1933)	89.78%	69.21%	50.12%	82.10%	80.68%

Figure 3

The Great Recession

Considered by many to be the worst global economic crisis since the Great Depression, the Great Recession began similarly with the crash of the 8 trillion dollar housing market.

The Housing Market Crash

The housing market crashed largely due to the magnitude of subprime mortgages being offered, coupled by proliferation of financial products that marketed to individuals that could not afford particular mortgages to sign up for them, also contributing to the housing market crash. Many homeowners were forced to continue paying for their underwater mortgages. Between 2007 and early 2012 approximately 4 million homes were foreclosed, leading to housing prices to fall and more homes become foreclosed (Miller). After the housing market collapsed $19.2 trillion lost household wealth (Miller). The vicious foreclosure cycle fostered unemployment, as well as created stress on many banks and financial institutions that were forced to absorb billions of dollars in losses. Houses serve as a primary factor in homeowners' source of equity, the fall in housing prices accounted for three quarters of median household net worth falling from 126,400 in 2007 to 77,300 in 2010 (Miller).

The housing market crash served as the beginning for other institutions to fall. Lehmen went bankrupt and other large financial institutions such as Merrill Lynch, AIG, Freddie Mae and Fannie Mac came very close to following suit. Money Market withdraws were up at 144.5 billion dollars, compared to the 7.1 billion dollars the previous week, effecting corporations ability to roll over their short term debt. Unable to receive the investors' funds in exchange for most mortgaged back securities and other forms of asset backed commercial paper, investment banks and others in the shadow banking system were unable to provide funds to mortgage firms and other corporations, resulting in the freezing of one-third of the U.S lending firms (Mathiason).

Declining Consumer Spending

As an effect of the economic crisis, U.S consumption declined sharply in 2008, a departure from the previously seen trend of a steady increase of consumption patterns since 1980. The decline in consumption correlates with the sharp decrease in wealth as well as other macroeconomic effects and financial uncertainty as seen in figure 4.

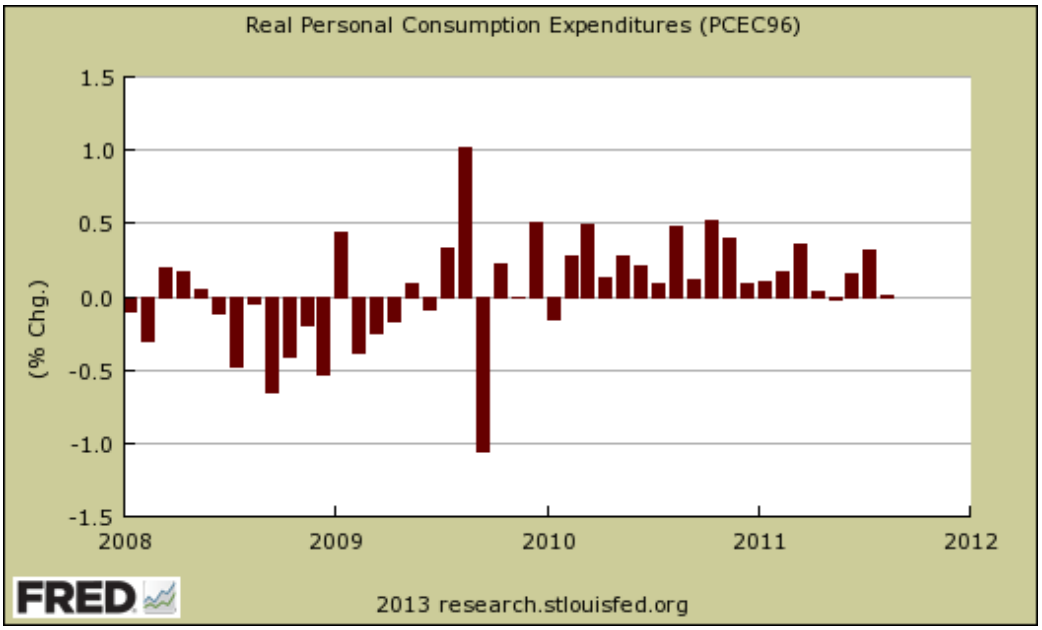


Figure 4

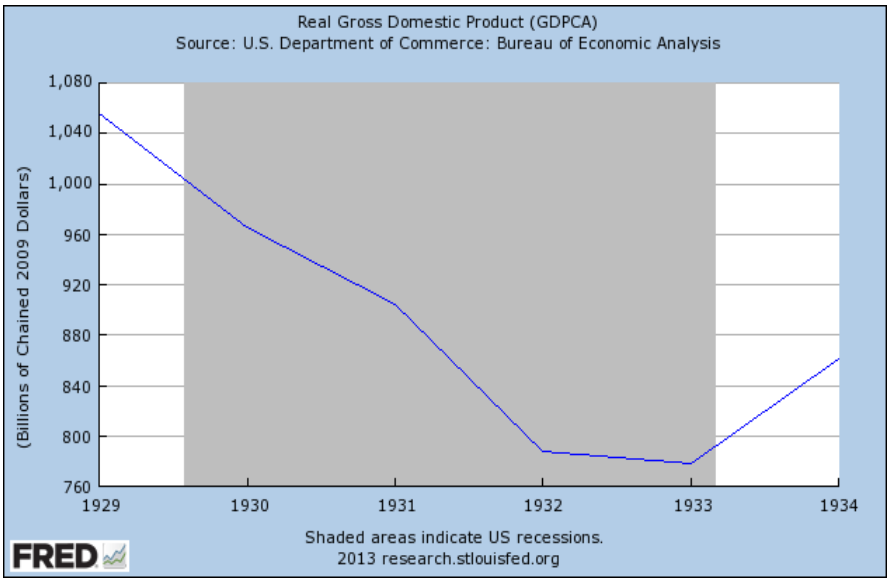
2. **The effects that both the Great Depression and Great Recession on the United States.**

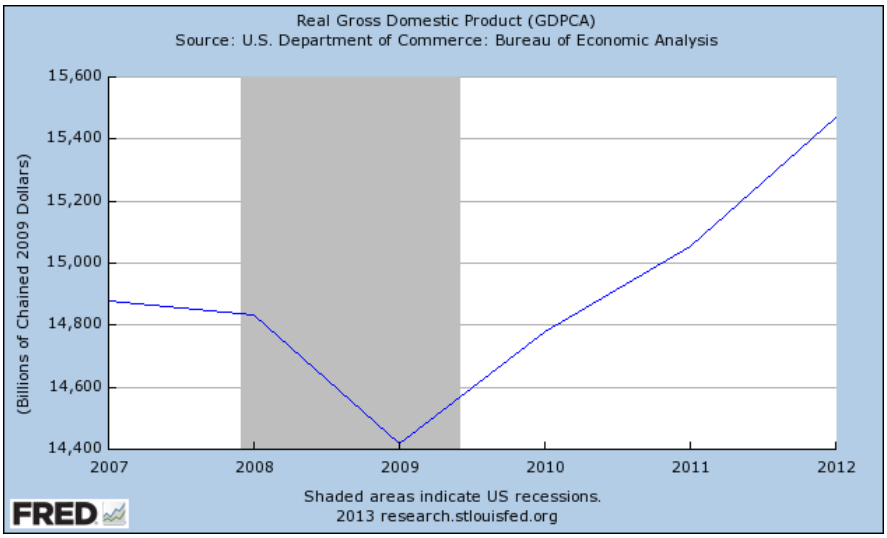
The Great Depression and the Great Recession may have many differences, but in respect to GDP, Unemployment rate, and inflation rates, they have quite a bit in common. We will start off with GDP.

GDP

Gross Domestic Product (GDP) is one of the key indicators of economic health. GDP is made up of government spending, consumer spending, investment, and exports minus imports. As stated above in the cause of the great depression, the stock market crashed, as a result investments and consumer spending decreased. The people no longer wanted to invest and didn't want to keep their money in the banks for risk of it disappearing, which by doing this, they were not putting their money back into the economy causing GDP to decrease. According to FRED economic data, during the great depression the GDP decreased 47.4 billion dollars from 104.6 billion to 57.2. (FRED) In a matter of four years and during the recession a decrease of 302.4 billion from14720.3 billion to 14417.9 billion (FRED). The hundreds of bank failures that happened the few years after the initial stock market crash, of the depression, caused

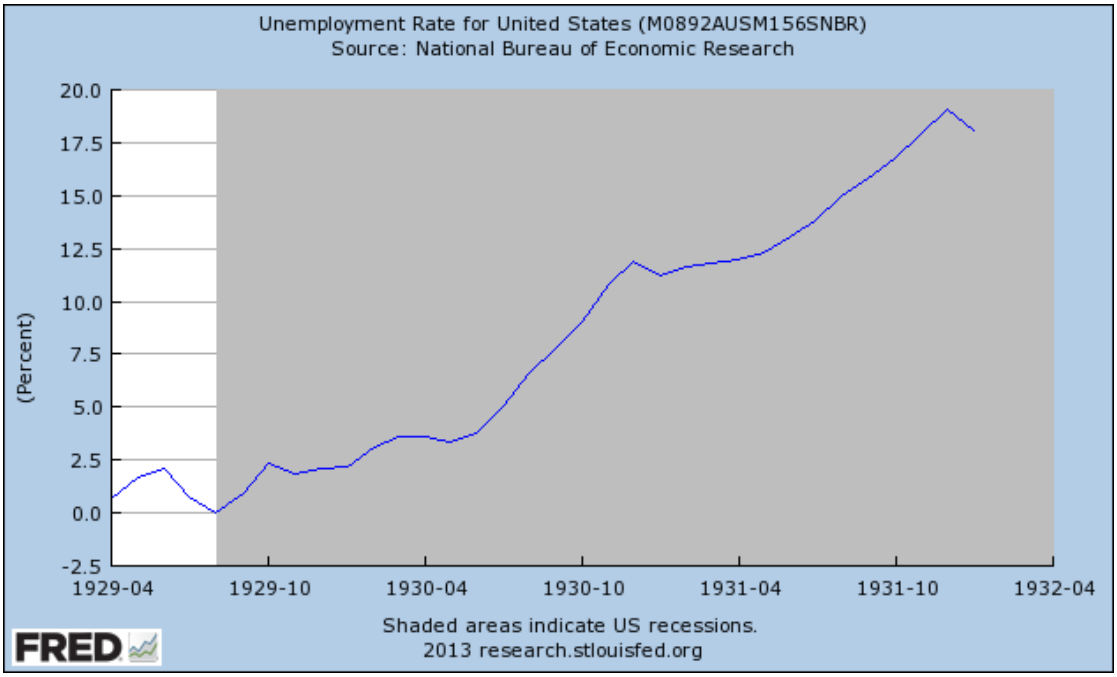
multiple billions of dollars to disappear because of the inability of the banks to pay the money back to the depositors, which of course also part of the reason why GDP decreased so much. Now in comparison to the great recession, there were bank failures but not as many as in the depression. Around 300 failures during the recession compared to over 4000 during the depression according to FRED data. The thing that made the biggest differences was the comparisons of sizes of those banks, during the depression the banks were smaller local institutions compared to larger institutions failing in the recession. These failures caused a similar problem though, which was the decrease of GDP even more. So as you can see the GDP was majorly affected by the effects of the great depression and recession.

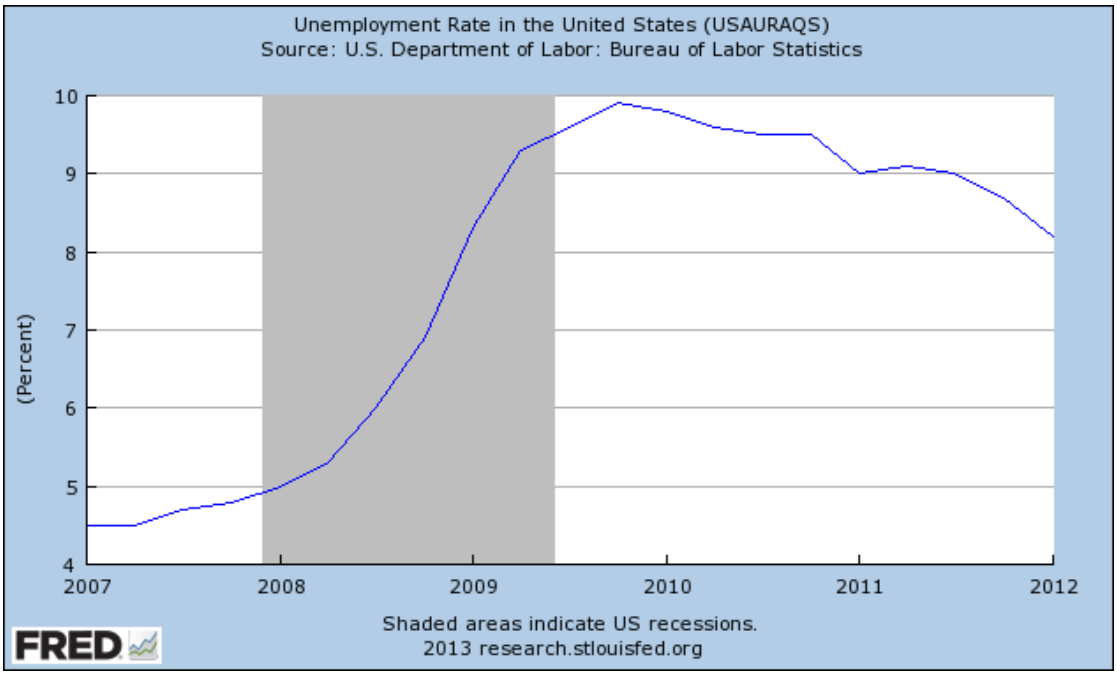




Unemployment rate

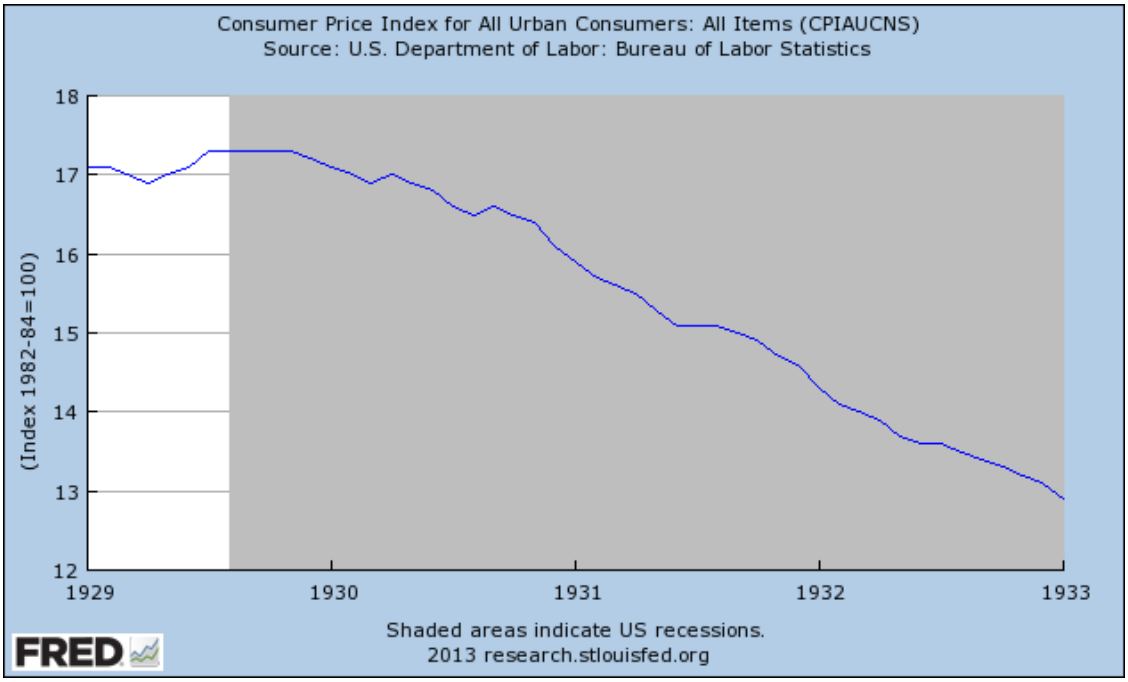
Another effect of these economic crises is the dramatic increase of Unemployment. The reasons for high unemployment are in both cases uniquely different but had a similar affect. During the depression, the main cause of unemployment was the dustbowl, which was when the farmland in the Midwest became useless because of bad farming techniques, causing wide spread unemployment in the Midwest. The Census Bureau information from the depression era shows that at the height of the great depression the unemployment was around 24.9%. (FRED) The recession was a different story, the unemployment was caused by large lay-offs by multiple companies to offset the economic price of the recession. According to FRED data the unemployment during the recession jumped from around 9% to close to 16%. (FRED) In both cases the longer the crisis, the higher the unemployment would get until, something corrects it. The higher the unemployment the larger effect it will have on the economy, because there will be a larger portion of the population not putting money back into the system. The third large effect the depression and recession had on the economy was the inflation rates.

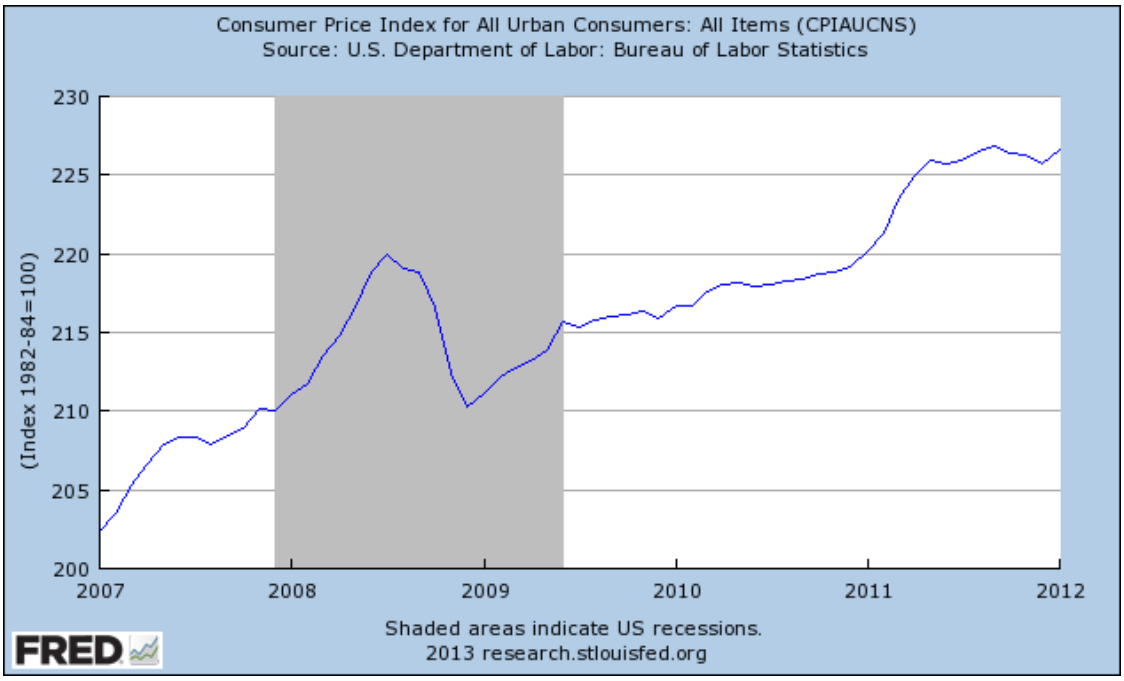




Inflation rate

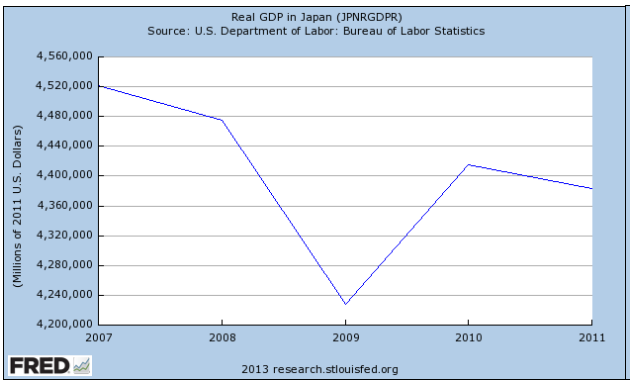
The inflation rate during the great depression and great recession caused the dollar not to inflate but to do quite the opposite. To start off, during the great depression the inflation rate went from zero in 1929 to -11.38 in 1932. (FRED) A deflationary interest rate is when the currency of a country becomes of more value. So, during the great depression the inflation rate was made negative to create an environment that would decrease price levels and encourage spending in order to get out of the economic crises. Now in the case of the great recession, the inflation rate also fell. Although it wasn't as dramatic as during the depression it still fell a considerable percent. It fell from 4.28 in 2008 to 0.3 in 2009. (FRED) This tactic, just like the depression, was applied for the same reason to lower price levels, which could then increase consumer spending. Inflation rates during both events caused more speculation in the area of spending as the population will wait till deflation hits the bottom and they are getting everything for free. Each of these affects were major side-effects from large financial problems. While in all of the affected cases there looked like there was no way out, but there is.

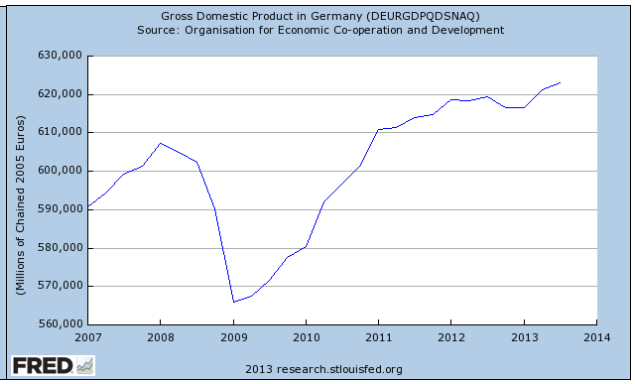

Consumer Price Index for All Urban Consumers: All Items (CPIAUCNS)
Source: U.S. Department of Labor: Bureau of Labor Statistics
(Index 1982-84=100)
18
17
16
15
14
13
12
1929
1930
1931
1932
1933
Shaded areas indicate US recessions.
2013 research.stlouisfed.org
FRED

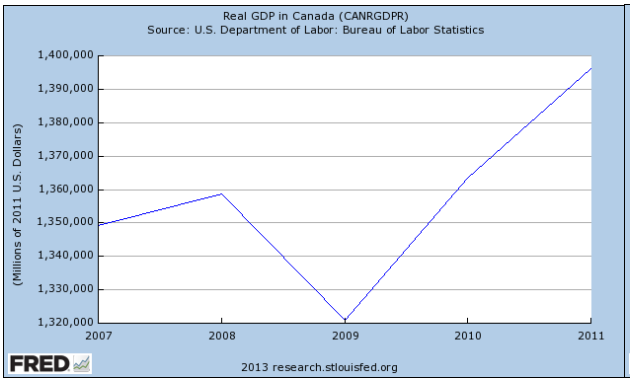

Consumer Price Index for All Urban Consumers: All Items (CPIAUCNS)
Source: U.S. Department of Labor: Bureau of Labor Statistics
(Index 1982-84=100)
230
225
220
215
210
205
200
2007
2008
2009
2010
2011
2012
Shaded areas indicate US recessions.
2013 research.stlouisfed.org
FRED

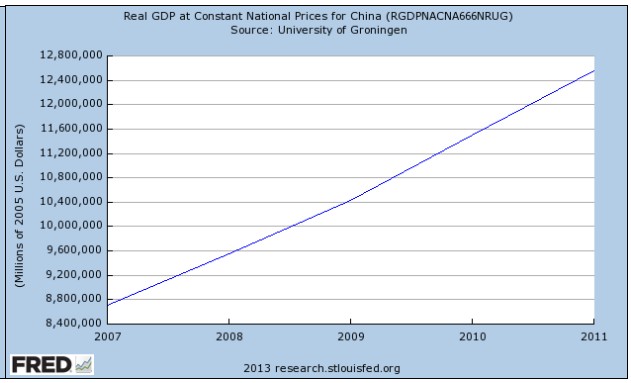
International GDP

The U.S was not the only country affected by the Recession and Depression. Other Countries such as Japan, Germany, and Canada also had similar economic problems. As can be seen by these graphs from FRED. The GDP in all of these showed a considerable decrease at the time of the great recession except for China. China was not largly effected by the Great Recession.









3. **How the government approached remedying the great recession and the great depression through economic policy, as well as whether or not the economy has currently recovered.**

Since the Great Depression and Great Recession, multiple economic policies have been put into place to insure that these detrimental economic occurrences never happen again. Although from a financial standpoint we have been showing signs of a recover, we still need complete agreements within congress to make sure that situations like these are avoided by taking the correct course of action instead of waiting for the worst possible scenario. First, we have the remedies during the Great Depression.

The Great Depression

During the great depression, our economies financial markets were dealing with a completely unorganized system of regulation and codes. The Securities and Exchange Commission (SEC) is an agency of the United States federal government. It holds primary responsibility for enforcing the federal securities laws and regulating the securities industry, the nation's stock and options exchanges, and other electronic securities markets in the United States. The Securities Exchange Act of 1934 is where it all began. The SEC enforces the Securities Act of 1933, the Trust Indenture Act of 1939, the Investment Company Act of 1940, and the Sarbanes-Oxley Act of 2002 which is the most recent in our lifetime. The main reason for the creation of the SEC was to regulate the stock market. To achieve its mandate, the SEC enforces the statutory requirement that public companies submit quarterly and annual reports, as well as other periodic reports. In return, the SEC makes the reports available to the public so that markets will become more efficient.

The Banking Act of 1933

The Banking Act of 1933 joined together two long-standing Congressional projects: (1) a federal system of bank deposit insurance championed by Rep. Steagall and (2) the regulation or prohibition of the combination of commercial and investment banking and other restrictions on "speculative" bank activities championed by Sen. Glass as part of a general desire to "restore" commercial banking to the purposes envisioned by the Federal Reserve Act of 1913. Supporters of the Act cite it as a central cause for an unprecedented period of stability in the U.S. banking system during the ensuing four or, in some accounts, five decades following 1933.

The Federal Deposit Insurance Company (FDIC) mitigates any potential damage to the United States economy by insuring deposits made to banks and other financial institutions. Savings, checking, individual retirement accounts (IRAs) and other deposit accounts are insured up to $250,000 per depositor. This led investors to stop worrying about losing their savings up to that amount which gave banks a better chance at keeping money in their bank.

The Great Recession

Fiscal Policy is the use of government revenue collection (taxation) and expenditure (spending) to influence the economy. When the housing market flipped back in 2008-2009, investors weren't blind as to what could potentially happen if they invested their money into sub-prime mortgages. This led investors to hold their money and spend less. The Fiscal Policy creates a means for the government to increase or decrease spending based on how the economy is doing at any given time. The government wanted a serious push for investor spending because they believed the economy would be stimulated with a stronger flow of currency into the markets. To make this possible, the interest rates on loans were lowered and policies were put into the housing market to ensure that sub-prime mortgages would never happen again. The United States is still recovering from the Great Recession, but getting people to spend their money is the first step into the correct direction.

Tax Relief Act of 2010

The Tax Relief Act of 2010 was the first act that President Obama put into place under his new system. The Act centers on a temporary, two-year reprieve from the sunset provisions known at the Bush tax cuts. The act also includes several other tax and economy related measures intended to have a new stimulatory effect, mostly notably an extension of unemployment benefits and a one-year reduction in the FICE payroll tax, as part of a compromise agreement between Obama and Congressional Republicans. Basically, this act gave relief to the "Middle Class Working Family" and allowed for them to receive small tax cuts while those families making over a certain income did not see these reliefs immediately. This allowed more money for people to spend into different markets which Obama and his administration believes is the key to getting out of the Recession completely.

Troubled Asset Relief Program

The Troubled Asset Relief Program (TARP) is a program of the U.S. government to purchase assets and equity from financial institutions to strengthen its financial sector that was signed into law by U.S. President George W. Bush in 2008. It was a component of the government's measures in 2008 to address the subprime mortgage crisis. TARP allowed the U.S. Department of the Treasury to purchase or insure

up to $700 billion of "troubled assets." In short, this allows the Treasury to purchase illiquid, difficult-to-value assets from banks and other financial institutions. The targeted assets can be collateralized debt obligations, which were sold in a booming market until 2007. TARP is intended to improve the liquidity of these assets by purchasing them using secondary market mechanisms, thus allowing participating institutions to stabilize their balance sheets and avoid further losses.

Conclusion

The two crises Great Depression and Great Recession has a lot of things in common. They are characterized by a huge decline in economic activities, what affected not only the stability of the economy of the U.S. but it expanded on the whole world influencing on social, cultural and political sectors. The crises were created because of big market failures, during the Great Depression it was the failure of stock market, and the Great Recession was created because of the housing market failure. As in 1930 people were investing a lot of money buying stocks, so in 2007 people were investing in housing through subprime mortgages. But in both cases, people were unable to pay for stocks and houses, and within a huge decrease in demand for this products, there were big declines in economic activities. There are a lot of different causes except of just only housing and stock markets' failures, for example according to some studies the great depression was caused also because of decline in agricultural income in 1920, and during the great Depression, one of the main reasons was that the government set a very low interest rate. Even though two crises had different causes, they had a lot of in common.

Two crises had a big effect on economic variables such as GDP, unemployment and inflation. GDP in both crises was largely decreased. The main components of GDP consumption and investment felt down, people did not want to invest because of the high level of risks of banks during depression, the consumption of durable and non-durable goods in two contractions declined, what leaded to the fall of the GDP. However the GDP of recession fell more than of the depression because during the depression the financial institutions were not as big as in 2007. The second economic variable was unemployment level. The causes of declined unemployment were different, in depression the employment of farmers decreased

due to the useless skills of farmland in Midwest, and during recession the unemployment was caused by large lay-offs by multiple companies to offset the economic price. And there is also another economic variable the inflation rate. During both events the inflation was made to be negative in order to decrease the prices of products and increase spending on consumption, however there were speculators which were waiting for the more fall of prices in order to get cheaper products.

There were made a lot of policies in solving the problems of economic crises. The Great Depression was maintained by Securities and Exchange Commission through the Securities Exchange Act 1934, and there also was set a Banking Act of 1933. The FDIC insured deposits to the banks, what decreased the risk and made investors less worried. The Great Recession was maintained through fiscal policy, there was established The Tax Relief Act of 2010 directed to the decrease of taxes, what lead to the increase of spending, somehow we are still on the stage of the recovery from the crises.

The research on the Great Depression and Great Recession helped us understand the main causes of the crises and analyze the huge consequences on economic activities. The parallel between two events showed the big connection between two contractions and it also proved the phenomenon of business cycle, when the crisis follow the economic booms, what happened in 1929 and 2007.

Works Cited

[1] FRED. Economic Research Federal Reserve Bank of St. Louis. 2013. October 2013.

[2] Friedman, Milton, and Anna Jacobson. Schwartz. *A Monetary History of the United States: 1867-1960*. Princeton: Princeton UP, 1971. Print.

[3] Mathiason, Nick. "Three Weeks That Changed the World." *The Guardian*. The Observer, 27 Dec. 2008. Web.

[4] Miller, Jake. "Issue Brief: Housing." *CBSNews*. CBS Interactive, 1 Oct. 2012. Web. 28 Oct. 2013. <http://www.cbsnews.com/8301-505103_162-57523544/issue-brief-housing/>.

[5] New York Times. 3 Dec. 2013. <http://topics.nytimes.com/top/reference/timestopics/subjects/g/glass_steagall_act_1933/>.

[6] Perez, William. 20 Dec. 2013. “Tax Relief Act of 2010.” <http://taxes.about.com/b/2010/12/20/the-tax-relief-act-of-2010-income-tax-provisions.htm>.

[7] Sarka, Deepa. “Legal Information Institute.” Securities Act of 1933. 3 Dec. 2013. <http://www.law.cornell.edu/wex/securities_act_of_1933>.

[8] Suddath, Claire. "U.S." *TIME.com*. TIME, 29 Oct. 2008. Web. 26 Oct. 2013. <http://content.time.com/time/nation/article/0,8599,1854569,00.html>.

[9] Wattenberg, Ben. "Stock Market Crash." *PBS*. PBS, n.d. Web. 26 Oct. 2013. <http://www.pbs.org/fmc/timeline/estockmktcrash.htm>.

[10] 28 Oct. 2013. <http://www.theguardian.com/business/2008/dec/28/markets-credit-crunch-banking-2008>.