

Crisis and Risk: Lessons from Two U.S. Crises

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Two Crises: 1930s and 2008-

★ Differences in magnitude and kind ★

Real GDP decline from peak to trough

1930s: ~20 percent

2008-: 3.7-6.2 percent

Duration

1930s: 44 months

2008-: 20/21 months

Two Crises: 1930s and 2008-

★ Differences in magnitude and kind ★

Unemployment Rate

1930s: 3+ percent → 24+ percent

2008-: 5+ percent → 10+ percent

Deflation

1930s: -26 percent

2008-: 5 months in Fall 2008 (oil)

less than 2% over period

Two Crises: Reasonable Warning?

1929-1933

Problems with return to parity/operation of gold standard

Stock Market Crash

Fed had already raised interest earlier

Real GDP decline from peak to trough

Recovery in stock market by April 1930

Massive deflation of 1931 and 1932

Two Crises: Reasonable Warning?

2008-

2006 subprime mortgage defaults

Ongoing criticism of Fed's interest rate policies

2007-2008 run-up in oil prices

Warren Buffett-derivatives are nuclear bombs

U.S. current account deficits

Productivity declines in mid-2000s

Crisis and Economic Globalization

Globalization

Economic globalization

Market Integration

Labor Markets

Product Markets

Financial Markets

Recession and/or leads to temporary decline in integration

Medium-run decline in globalization

Two Waves of Economic Globalization

1870-1910

1950-2008

What ended the first wave of globalization?

1930s Crisis?

If so, will current crisis end the second wave of globalization?

In some ways...but different circumstances

Labor Market Integration I

1870-1910

National labor markets strongly linked

Williamson: wage convergence

Backlash in United States

Impact of World War I

Direct labor market integration over by 1921

Labor Market Integration II

Immigration to US did not resume until new legislation passed in 1965.

High levels of immigration from mid-1970s through 2006.

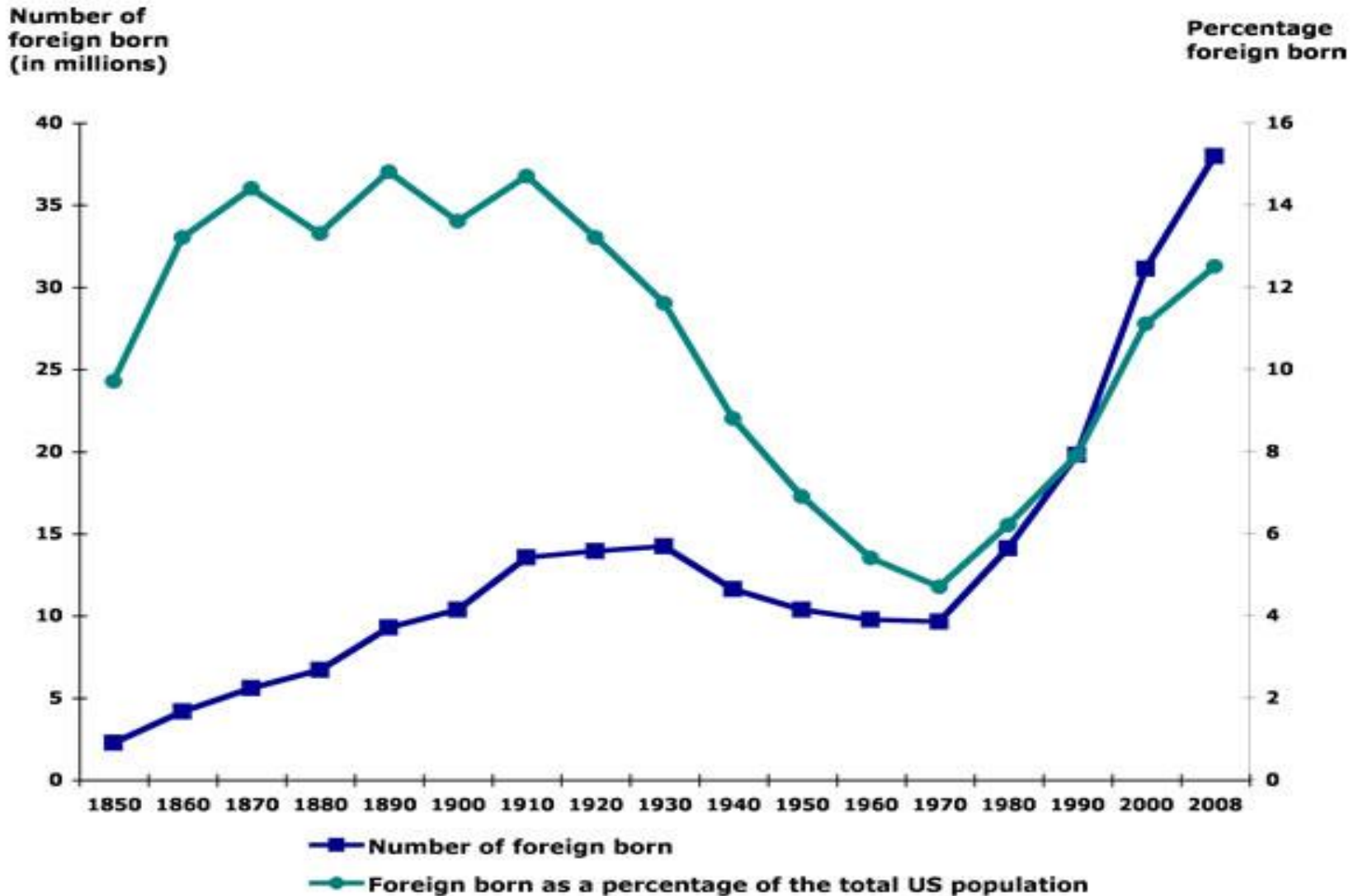
One million annually from 2000-2006.

2006-2007: Decline to 500,000

2007-2008: 0

Mexican migrants return home.

Foreign-Born Population and Foreign Born as Percentage of the Total US Population, 1850 to 2008



Product Market Integration

Tariff Changes

1860-1910—12 percent → 17 percent.

World War I—Inflation-led fall to 8 percent.

1920s—restoration to 15 percent.

1930s—deflation-led increase to 25 percent.

1934—new more flexible framework adopted.

Post-1950—successive rounds of tariff declines

Little evidence of increasing tariffs prior to

2008 Crisis

Financial Market Integration

1870-1910

Gold Standard and investment flows

Massive flows to Americas, Asia, developing Europe

World War I—change in creditor status

Decline in lending during 1920s

1955-2008-

Repeal of capital controls

Increased political stability

Decline in long-term interest rates

Recovery Policies

- Increasing evidence on low power of multiplier policies in 1930 and small use of Keynesian deficits; tax increases in 1933.
 - Barro (2009)
 - Fishback (2010)
- Policies to help homeowners
 - Underwater mortgages
 - Inability to pay mortgages
- NIRA
- Strong recovery in 1930s from US leaving gold standard, restoring confidence in banks, inauguration of President Roosevelt.

Other Great Depression Lessons

- Calomiris—Lender of last resort?
- Calomiris and Bernanke—Irreversibility of bank distress; debt-deflation.
- Eichengreen; Bordo; Romer—Gold standard spread crisis; Taylor-staggered contracts.
- Wallis—depression differed in scale-scope by region; recovery differed by region.

Lessons for China I

Major crises come with little warning.

Cause of crisis is not perceived to be of major quantitative significance prior to crisis.

Little experience in dealing with internal crisis.

Avoiding deflationary expectations

Effectiveness of fiscal policy

Lessons for China II

Four banks that are too big to fail.

Government guarantees to quasi-private, quasi-public firms.

Search for firms that could generate similar problems as AIG.

Lender of last resort vs. bank bailouts.

Policy and regional differences.

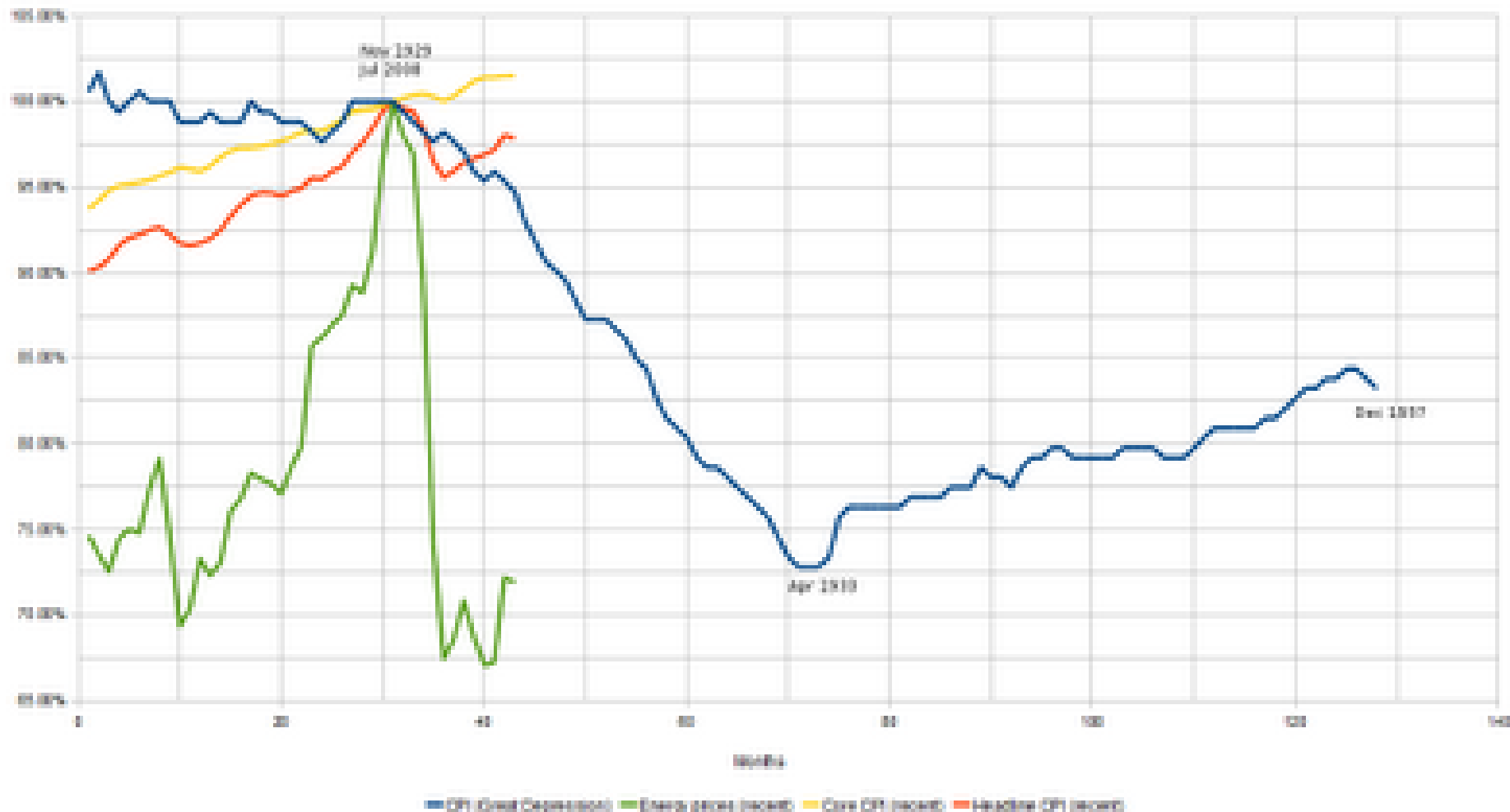
Consumer Price Index Trends: US Great Depression versus US Today

Source: BLS

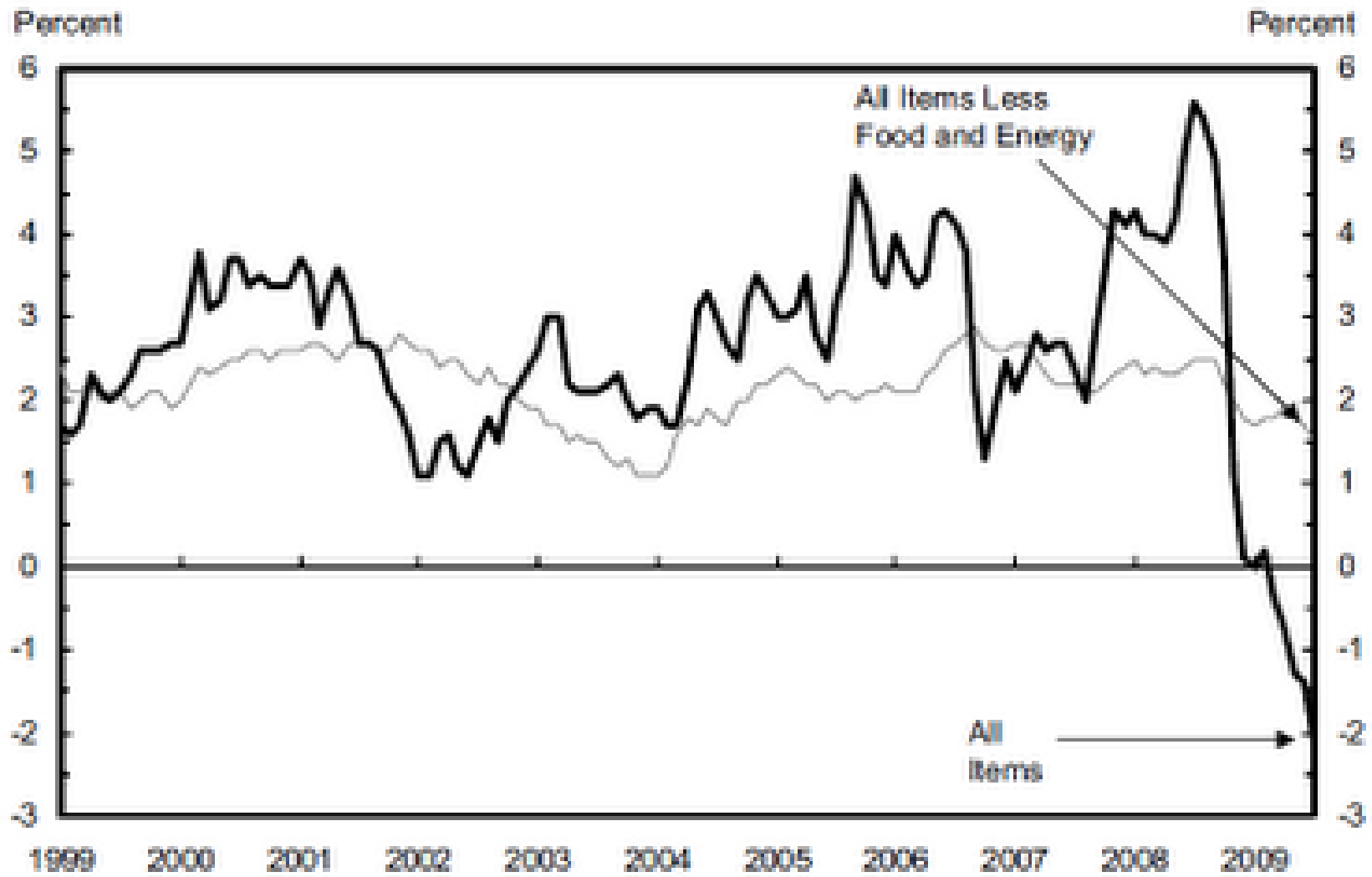
Chart: thoughtofferings.com

Great Depression prices are % relative to Nov 1913 CPI peak.

Recent prices are % relative to Jul 2008 CPI peak.



CPI-U 12-Month Changes, 1999 to Present



GDP During The Great Depression

2000 Dollars

Current Dollars

