RESEARCH INSIGHTS

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The Great Depression of 1930 vs. The Great Recession of 2008

Abstract

The 1929 stock market crash and the subsequent 'Great Depression' was the world's worst and biggest economic disaster. Despite its origins in the United States, the Great Depression caused substantial drops in output, high unemployment, and acute deflation in nearly every country of the world.
Therefore, when the Subprime Mortgage Crisis of 2007-08 struck many predicted that we were about to experience another depression on a similar scale, or at least what some have termed a 'great recession'.
In this article, we aim to compare and contrast the two economic crises, analyse their differences and similarities, and most importantly the impact they had on the global economy.

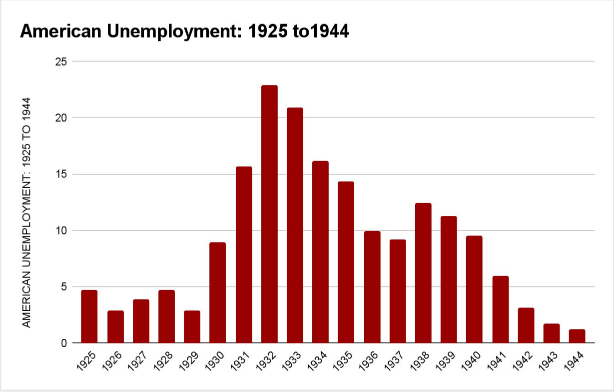
Keywords: economic crisis, unemployment, subprime mortgage, recession

The Great Depression

1. Causes: Why was it the ultimate snowball effect?
The snowball effect is a process that starts with something fairly small until it builds in size to become very powerful. The stock market crash of 1929 was by no means small; instead, it was the beginning of the giant snowball known as 'The Great Depression'. The economic depression that lasted for 10 long years began after the end of the Roaring Twenties - October 24, 1929 - the day the stock market tanked. That day is also known as *Black Thursday*.

Two months later, stockholders had lost over USD 40 billion. The major loss in capital from Black Thursday resulted in over 9,000 banks failing. Those banks being uninsured led to people losing their entire life savings. Banks that did survive were too hesitant to provide new loans - slowing down the economy even further and creating a bigger snowball.
People of all classes stopped buying things. With no one buying anything, sellers stopped their production. That caused more job losses. At one point, unemployment was over 25%.

As the businesses continued to fail, the Government increased the taxes on imports. This new tariff didn't help at all, infact, it added to the snowball as trade and demand for US goods decreased.
The stock market, high taxes, closing of banks, and high unemployment all combined caused The Greatest Depression the world has seen.



Source: Nathan, Robert R., "Estimates of Unemployment in the United States, 1929-1935", *International Labour Review*, vol. XXXIII, no. 1, January 1936, p. 49.

2. Life during The Depression
"*Use it up, wear it out, make do or do without*." was the motto that people used to survive the depressing 30s.
Severe unemployment led to people living on the streets. Some even slept in sewer pipes and used newspapers to fend off the cold. Conditions for African-Americans were even more difficult. Their unemployment rates were higher and those who were employed were paid very little. In 1933, twenty-four African-Americans died by lynching.
The Great Depression also hugely affected children. Poor diets and a lack of money for health care led to serious health problems. Clinics and hospitals reported a dramatic rise in malnutrition and diet-related diseases, such as rickets.
In Europe, people were already suffering under the Nazi Rule. The Great Depression added to their sufferings economically. A similar case was for most Asian countries as well.

3. How did it end?
Franklin D. Roosevelt was elected as the US President in 1932. He promised to create federal programs that would end the economic depression. The newly elected president signed the 'New Deal' which included programs such as Social Security, the Securities and Exchange Commission, and the Federal Deposit Insurance Corporation. These programs were designed to create jobs and provide unemployment insurance. However, many economists and historians still argue that it was The World War II that had brought the Great Depression to an end and not the New Deal.

The Great Recession

1. The Big Short

Following the 9/11 terrorist attack, the US Government, with good intentions, lowered the federal funds rate from 6.5% to 1% in June 2003. This resulted in increased home prices as borrowers took advantage of the low mortgage rates. Even those with poor or no credit history were able to get a house loan. Soon a big secondary market for originating and distributing subprime loans developed. Credit rating agencies were also not regulated properly. They gave AAA ratings to the risky Mortgage-Backed Securities.

Eventually, in 2007, the housing market saturated, and the bubble burst. Subprime borrowers defaulted and the lenders filed for bankruptcy.

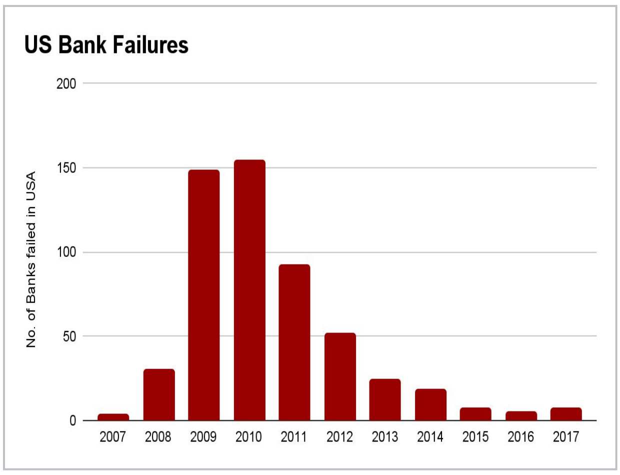
2. The Domino Effect

The U.S. economy was in a full-blown recession. The bad news continued to pour in from all sides - nationalisation of Northern Rock by the British Government - Bear Stearns collapse - fall of the Lehman Brothers - Fannie Mae and Freddie Mac seized. More than 500 banks failed between 2008 and 2015.

The 2007-2008 financial crisis was a global event and not restricted to the U.S. Ireland's vibrant economy fell. Greece defaulted on its international debts. Portugal and Spain suffered from extreme levels of unemployment. Every nation's experience was different and complex.

3. Aftermath

In October 2007, existing-home sales fell 1.2% to a rate of 4.97 million. The crisis in banking got worse in 2008. Banks that were highly exposed to mortgage-backed securities soon found no one would lend to them at all. Unemployment reached 10%. About 3.8 million Americans lost their homes to foreclosures. According to Federal Deposit Insurance Corporation (FDIC) data, more than 500 banks failed from 2008 to 2015.



Source: https://www.fdic.gov/bank/historical/bank/

So, to stabilise the economy, Governments responded with fiscal stimulus and monetary policy expansion - Emergency Economic Stabilization Act of 2008.

1930 vs 2008

Just like the Great Depression, the 2008 financial crisis struck after the global economy went through a boom period. Also, in both the cases, the epicentre was New York.

Both the crises had a major impact on the world economy. However, the countries involved in 1930 accounted for 55.6% of world GDP, while the figure in 2008 reduced to 33.5%

One big lesson that The Great Depression of 1930 had taught us was not to be passive during such adverse financial shocks. As a result of which, aggressive monetary and fiscal policies were immediately implemented to halt the financial disintegration in 2008. Flexible exchange rates gave policy-makers the freedom to use devaluation as an aid to recovery. These learnings had helped us to avoid the repetition of the 10-year long damage caused during the Great Depression.

Basis	Great Depression of 1930	Great Recession of 2008
Bank failures	9,000+ bank failures in the Great Depression, representing 50% of all banks nationwide.	57 bank failures in the Great Recession representing 0.6% of all banks.
Stock market	The Dow Jones Industrial Average lost nearly 90% of its value during the Great Depression.	Dow lost about 50% of its value before recovering.
Emergency spending programs	The federal government spent 1.5% for 1 year during the Great Depression.	During the Great Recession, the federal government spent 2.5% of GDP for 2 years.

Source: https://money.cnn.com/news/storysupplement/economy/recession_depression/

Concluding from the above table, we can say that a dramatic financial collapse has been averted, economic recovery, though tenuous, is progressing, and unemployment has not reached the levels that some commentators feared when the downturn in 2007 began.

Writer's Opinions

It is true that the equity markets have recovered to a large degree compared with their initial drop; however, it still remains considerably below the pre-crisis levels (boom period). Although there are signs that the global crisis may not be as severe as the Great Depression; however, recent economic forecasts in no way suggest that there will be a clear path to recovery in the near future.

The Great Lockdown due to Covid-19 has also impacted our economy severely. In comparison to the Great Depression and the 2008 Financial Crisis, the impact of the current economic crisis on the real economy has been much hastier and very immediate as both supply and demand sides have been paralysed together, which only got worse by globalisation.

Simultaneously, this crisis has spread to the financial sector as a result of rising corporate debt, which had been building up since the 2008 crisis. However, despite the significant damage to the real economy and the financial sector, there is still hope for a faster recovery than we had during 1930 and 2008. Because, unlike the constraints faced during the Great Depression like the gold standard, we are now living under a much-diversified financial system that has enabled the central banks and governments to play (especially the FED) a more powerful role than they did even during the Great Financial Crisis of 2008. However, multilateral cooperation between countries is still weak, which is crucial to prevent the pandemic from having long-term consequences on the global economy.