Practical Activity.

“The Great Depression.”

Economic History

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Suggested citation

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- CONVOCATORIA PARA EL IMPULSO Y LA CONSOLIDACIÓN DE PROYECTOS DE DOCENCIA BILINGÜE DURANTE EL CURSO 2017/2018 (**Resolución Rectoral 787/2017, de 26 de julio de 2017**)

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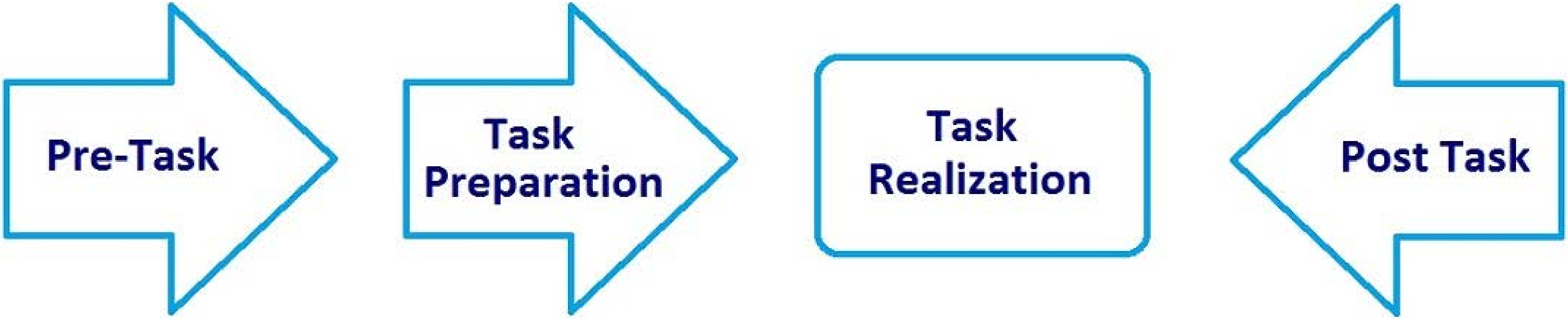

Pre-Task
Task Preparation
Task Realization
Post Task

- **Reference**
- Álvaro-Moya, A. y Fernández Moya, María (2014): "¿Estamos reviviendo la crisis de 1929? / Coming back to 1929?",*Practicum de la Asociación Española de Historia Económica,* 20, junio-diciembre 2014, ISSN: 2255-5005 http://www.aehe.net/docencia-seccion/practicum/2014/20_reviviendo_crisis.pdf)

- **Outline**

- 1. Video support

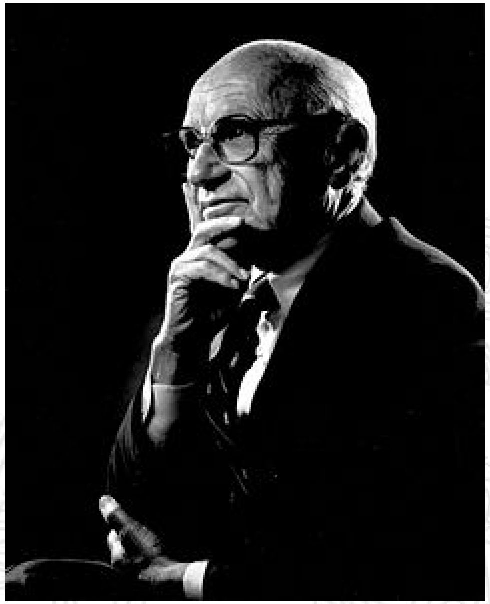
- 2. Friedman, Milton, and Friedman, Rose D. (1980), *Free to choose*, New York, Harcourt Brace Jovanovich.

- 3. Krugman, Paul "Partying Like It's 1929", *New York Times* [21.03.2008]. [http://www.nytimes.com/2008/03/21/opinion/21krugman.html?_r=0].

- 4. "This time is different…"

- **Task 1.**
- 1. Video support
- 1929. The great depression. Part 1
- https://www.youtube.com/watch?v=bCEJ65H_1XE
- 1929. The great depression. Part 2
- https://www.youtube.com/watch?v=gO42ZfCN9ug&t=6s

- **Task 2.**
- Milton Friedman and Rose Friedman
- Milton Friedman
- Nobel Prize 1976: consumption analysis, monetary history
  Monetarism: school of thought that highlights the key-role of the Goverment controlling the amount of money in circulation
- (R. Reagan advisor)



Source: https://commons.wikimedia.org/wiki/File:Portrait_of_Milton_Friedman.jpg

- **Friedman, Milton, y Friedman, Rose D. (1980), *Free to choose*, New York, Harcourt Brace Jovanovich.**
- “In the real of ideas, the depression persuaded the public that capitalism was an unstable system destined to suffer ever more serious crises. The public was converted to views that had already gained increasing acceptance among the intellectuals: government had to play a more active role; it had to intervene to offset the instability generated by unregulated private enterprise; it had to serve as a balance wheel to promote stability and assure security”

- “The popular view is that the depression started on Black Thursday, October 24, 1929, when the New York stock market collapsed. After several intermediate ups and downs, the market ended up in 1933 at about one-sixth the dizzying level of 1929. The stock market crash was important, but it was not the beginning of the depression”

- “These depressing effects of the stock market crash were strongly reinforced by the subsequent behavior of the Federal Reserve System (…). The combined effect of the aftermath of the stock market crash and the slow decline in the quantity of money during 1930 was a rather severe recession. Even if the recession had come to an end in late 1930 or early 1931, as it might well have done if a monetary collapse had not occurred, it would have ranked as one of the most severe recessions on record. But

- “the worst was yet to come. Until the autumn of 1930 the contraction, though severe, was not marred by banking difficulties or runs on banks. The character of the recession changed drastically when a series of bank failures in the Middle West and South undermined confidence in banks and led to widespread attempts to convert deposits into currency”

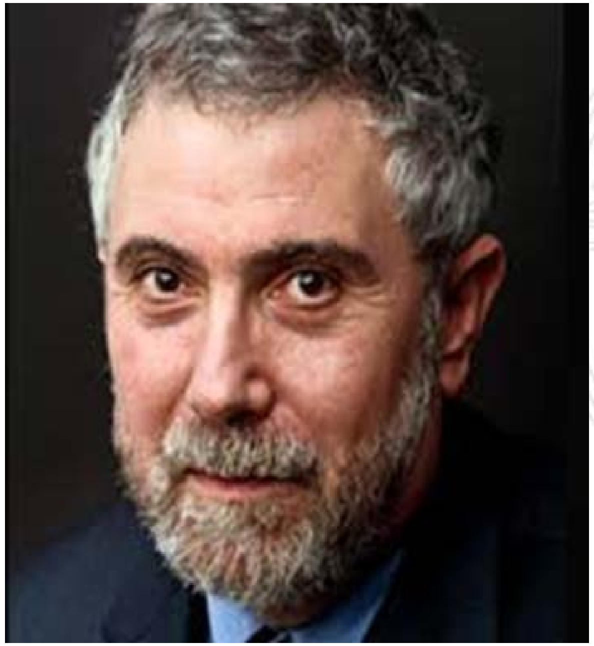
Task 3.

- Krugman, Paul “Partying Like It’s 1929”, *New York Times* [21.03.2008]. [http://www.nytimes.com/2008/03/21/opinion/21krugman.html?_r=0]
- Keynesian Economist
- Nobel Prize in Economics (2008)

for his contribution to New Trade Theory

and New Economic Geography.

- [Yale, MIT, Stanford, Princeton, NYU]
- Columnist at NYT



- “If **Ben Bernanke (1)** manages to save the financial system from collapse, he will — rightly — be praised for his heroic efforts. But what we should be asking is: How did we get here? Why does the financial system need salvation? Why do mild-mannered economists have to become superheroes? The answer, at a fundamental level, is that we’re paying the price for willful amnesia. We chose to forget what happened in the 1930s — and having refused to learn from history, we’re repeating it”.

(1) Ben Bernanke: Chairman of the Federal Reserve (2006-2014)

- “Contrary to popular belief**, the stock market crash of 1929 wasn’t the defining moment of the Great Depression**. What turned an ordinary recession into a civilization-threatening slump was **the wave of bank runs that swept across America in 1930 and 1931**”.

Great Depression (1929) & Great Recession (2008)

- Both crises are explained by the same two factors.
- I. World overproduction
  - fostered by the increase of industry productivity in Europe and the United States, as well as the great growth of “The Asian Tigers”
- II. Great capital flows
  - the emerging economies towards the advanced ones
    - banks began to not hold the mortgage portfolio granted, as they had done in the past.

- “This banking crisis of the 1930s showed that unregulated, unsupervised financial markets can all too easily suffer catastrophic failure”.

- In the four years between 1930-1933 alone, nearly 10,000 banks failed or were suspended.
- Depositors in these banks lost nearly 20% of their deposits when the banks failed.
- Since there was no FDIC (Federal Deposit Insurance Corp.) yet, and most state deposit insurance schemes had shut down already, this meant that Americans lost their savings, their money.

- "Worse yet, **bank runs can be contagious**. If depositors at one bank lose their money, depositors at other banks are likely to get nervous, too, setting off a chain reaction. And there can be wider economic effects: as the surviving banks try to raise cash by calling in loans, there can be a **vicious circle** in which bank runs cause a credit crunch, which leads to more business failures, which leads to more financial troubles at banks, and so on. That, in brief, is what happened in 1930-1931, making the Great Depression the disaster it was. So **Congress** tried to make sure it would never happen again by creating a system of regulations and guarantees that provided a safety net for the financial system".

Bank System Regulation after 1929 Crash

- Roosevelt administration’s recovery programs.
- Roosevelt’s Gold Program: suspension of the gold standard Gold Reserve Act (1934)
- Reform of financial regulation.
- Creation of deposit insurance
- Emergency Banking Act: Recapitalization of commercial banks
  - Bank Act of 1933 & Bank Act of 1935.

- **The Emergency Banking Act Of 1933**
- Requested for a four-day mandatory shutdown of U.S. banks for inspections before they could be reopened.
- Banks were only allowed to re-open once they were deemed financially sound.
- The act was passed during this shutdown, in hopes that Americans would renew their confidence by the time the banks re-opened.
- (It also extended the power of the president.)

- “And we all lived happily for a while — but not for ever after. Wall Street chafed at regulations that limited risk, but also limited potential profits. And little by little it wriggled free — partly by persuading **politicians to relax the rules**, but mainly by creating a “shadow banking system” that relied on complex financial arrangements to bypass regulations designed to ensure that banking was safe.

- “As the years went by, the shadow banking system took over more and more of the banking business, because the **unregulated players** in this system seemed to offer better deals than conventional banks. Meanwhile, those who worried about the fact that this brave new world of finance lacked a safety net were dismissed as hopelessly old-fashioned. In fact, however, we were partying like it was 1929 — and now it’s 1930”.

- “The financial crisis currently under way is basically an updated version of the wave of bank runs that swept the nation three generations ago. People aren’t pulling cash out of banks to put it in their mattresses — but they’re doing the modern equivalent, pulling their money out of the shadow banking system and putting it into Treasury bills. **And the result, now as then, is a vicious circle of financial contraction**”.

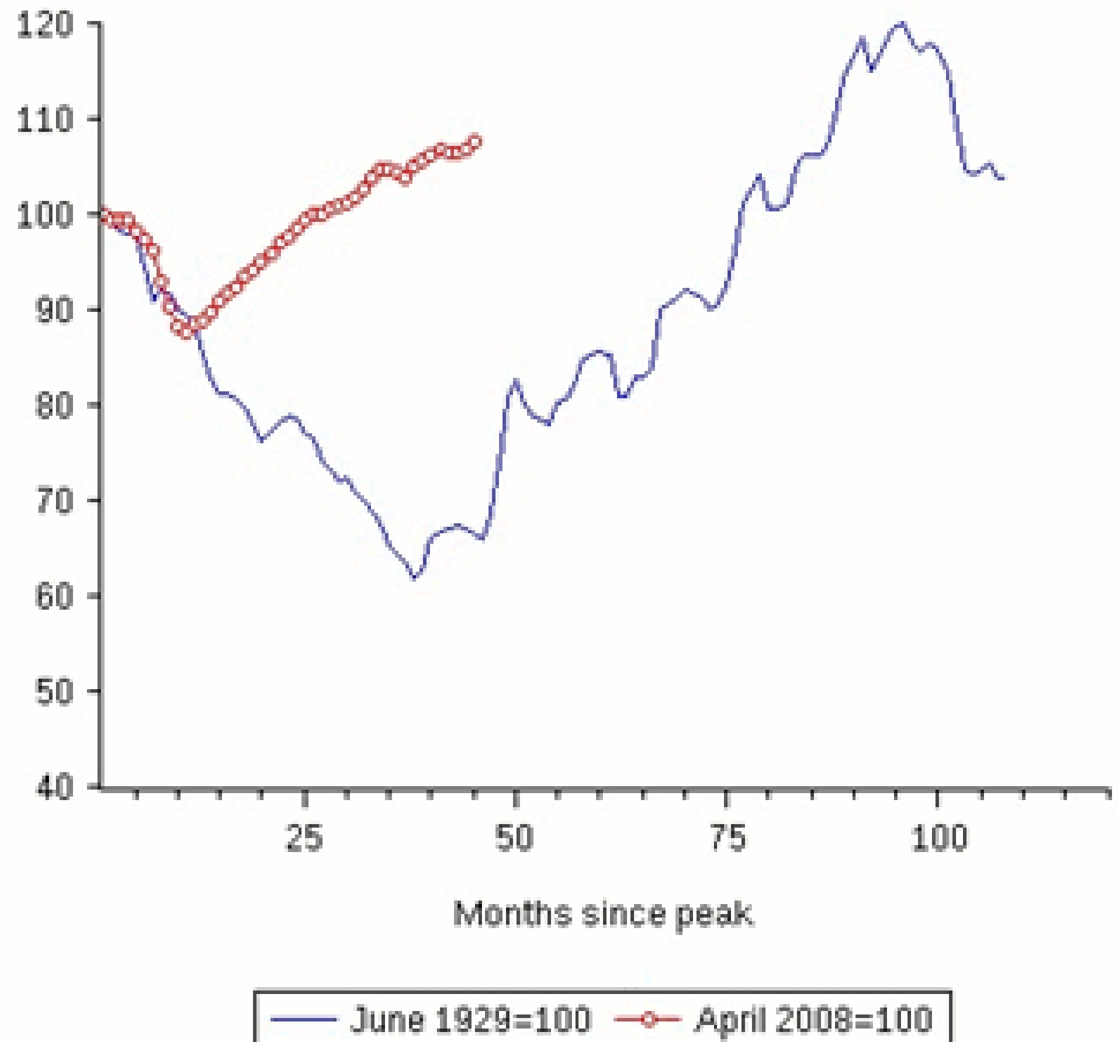
Key points.

- According to Paul Krugman:
- What turned an ordinary recession into a civilization-threatening slump in 1929?
- Regarding the Great Depression, which lesson had been forgotten when the current crisis exploded?

Task 4

- “This time is different…” **Subprime mortgage crisis**
- US 2007/2008-2010 (summer 2009)
- The first financial crisis of the 21st century and the second global crisis, after the Great Depression of the early 1930s.
- The global consequences of this crisis have been milder than those of the 1929 crisis.

- Figure 1.World industrial production, now vs. then [http://voxeu.org/article/tale-two-depressions-redux]



- Figure 2. Volume of world trade, now vs then [http://voxeu.org/article/tale-two-depressions-redux]