Is Another Depression Possible?: A Comparison of "The Great Depression" and "The Great Recession"

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In 2007, the world became engulfed in the largest economic slump since the Great Depression. The crisis was so damaging it was coined "the Great Recession" and there was much comparison of the recession to the Great Depression of the 1930s in the mainstream media. However, what many failed to do was an in-depth analysis of both the Great Depression and the Great Recession, to compare and contrast to two. Thus, this article will be a comparison of both economic downfalls, ending in an analysis of the current economic situation America finds itself in and asking the question if another Great Depression is possible.

The decade prior to the 1930s, the US was in a time of great economic boom known as "The Roaring Twenties." Yet while the nation's income rose about 20% (from $74.3 billion in 1923 to $89 billion in 1929), the majority of this wealth went to the richest as can be seen by the fact that "in 1929 the top 0.1% of Americans had a combined income equal to the bottom 42%" [1] and that the disposable income per capita rose 9% from 1920 to 1929, while the top 1% enjoyed a massive 75% increase in per capita disposable income. This greatly increased wealth disparity and led to a imbalance in the US economy where demand wasn't equal to supply and thus there was an oversupply of goods as "those [the poor and the middle class] whose needs were not satiated could not afford more, whereas the wealthy were satiated by spending only a small portion of their income," [2] which caused the US to become reliant on three things to keep the economy afloat: credit sales, luxury spending, and investment by the rich. However, the major flaw of an economy based on credit sales, luxury spending, and investments was that all three of those activities depended upon people's confidence in the economy. If confidence were to lower, then those activities would come to a halt and with it the US economy.

The massive inequality in wealth was not solely in terms of socioeconomic status, but also extended to corporations as well. During the first World War, the federal government subsidized farms in earnest as they wanted to feed not only Americans, but also Europeans. However, once the war ended, so did subsidies for farms. The government began to support the automobile and radio industries, with help from then-President Calvin Coolidge in the form of pressuring the Federal Reserve to keep easy credit, as to allow for both industries to easily be heavily invested in.

In the 1920s, the profits of the automobile and its connected industries such as lead, nickel, and steel skyrocketed, so much so, that by 1929 "a mere 200 corporations controlled approximately half of all corporate wealth." [3] The automobile boom also led to the creation of hotels and motels which in turn led "Americans spent more than a $1 billion each year on the construction and maintenance of highways, and at least another $400 million

annually for city streets" [4] in the 1920s. In addition to the massive success of the automobile industry, the radio industry also preformed exceptionally well as "Radio stations, electronic stores, and electricity companies all needed the radio to survive, and relied upon the constant growth of the radio market to expand and grow themselves." [5]

This dependence on two main industries to support the entire US economy led to quite serious problems as in the case of depending on the spending habits of the upper class to support the economy, if the expansion of either the radio or automobile industries slowed down or halted, the US economy would meet the same fate.

Still further, there was wealth inequality on the international banking scene. After World War 1, the Americans lent their "European allies $7 billion, and then another $3.3 billion by 1920" and by 1924 "the U.S. started lending to Axis Germany," eventually "climbing to $900 million in 1924, and $1.25 billion in 1927 and 1928" [6] The Europeans then used the loans to buy US goods and thus were in no shape to pay back the loans. One must realize that after World War 1, virtually all of Europe was hit hard economically by the war and thus unable to make any goods with which to sell, yet the US played a role as well due to its high tariffs on imports, thus increasing the difficulty in which Europe could sell goods and pay off its debt.

Yet, the massive wealth inequalities domestically were not the only problems that led to the stock market crash, financial speculation was rampant also, which allowed corporations to make huge amounts of money. As long as stock prices continued to rise, the corporation itself became near-meaningless. "One such example is RCA corporation, whose stock price leapt from 85 to 420 during 1928, even though it had not yet paid a single dividend." [7] This was a serious fundamental problem in the stock market as many forgot that if stock prices increase extremely quickly, a bubble is being created and sooner or later it will burst. This speculation greatly distorted the values of corporations. Usually, the stock price somewhat correlates with the performance of the company, but due to the rampant speculation, companies that were doing horribly could now seem as if they were great investments, all based on the increase in their stock price.

A factor that led to rampant speculation was the ability to buy stocks on margin, which allowed for one to buy stocks without actually having the money. Due to this, investors could potentially get extremely high returns on their investments. Buying stocks on margin was quite easy as the process

functioned much the same way as buying a car on credit. Using the example of [the RCA corporation], a Mr. John Doe could buy 1 share of the company by putting up $10 of his own, and borrowing $75 from his broker. If he sold the stock at $420 a year later he would have turned his original investment of just $10 into $341.25 ($420 minus the $75 and 5% interest owed to the broker). That makes a return of over 3400%! [8] (emphasis added)

This massive speculation led stock prices to incredibly high levels, with "the total of outstanding brokers' loans [being] over $7 billion" [9] by mid-1929.

The stock market bubble soon burst as on October 21, 1929, prices began to fall so rapidly that the ticker fell behind. Prices fell even further due to investors fears which led them to sell their shares. The speculation and wealth inequality caused a major undermining of the entire market which led to the wealthy ending their spending on luxury items and investing, as well as "[the] middle-class and poor stopped buying things with installment credit for fear

of loosing their jobs, and not being able to pay the interest," [10] and with it the US economy came to a griding halt. The lack of spending led to a nine percent decrease in industrial production from October to December 1929. This led to job losses, defaults on interest payments, and the destruction of the radio and automobile industries as inventory grew due to no one having the ability to purchase anything.

Internationally, loaning had already come to an abrupt halt earlier in the decade because "With such tremendous profits to be made in the stock market nobody wanted to make low interest loans" [11] and trade quickly ended as the US increased already high tariffs and foreigners quit purchasing US goods.

A topic that is rarely mentioned in regards to the Great Depression is the role of the Federal Reserve. The Fed played a major role in why investment purchases collapsed dramatically. The main problem was that in the onset of the Great Depression, there was rampant deflation. This was caused by the fact that the M1 money supply had reached a peak in 1929 and went downhill from there, yet the Fed didn't see this. Instead, they saw "only the statistics on the monetary base, the currency in circulation plus the funds held as reserves by the banks with the twelve Federal Reserve Banks," [12] which showed that the monetary base had been steadily increasing since about 1929. Thus, since the Fed saw that the money supply was increasing, they found no reason to act, when in reality, the M2 money supply was decreasing rapidly. However, in the late 1920s, the Fed acted to end speculative banking and wound up applying more restrictive monetary policies than thought. This resulted in banks closing en masse, which the Fed initially welcomed, yet this caused the banks and the banking public [to become] alarmed. Some people withdrew their funds from the banks. The banks became worried about withdrawal of deposits and even runs on banks. The banks reacted by holding reserves in excess of what the Fed required. [13]

This massive withdrawal of funds emptied the coffers of banks, thus causing the aforementioned deflation. The Fed's actions, along with the stock market crash, led to a 90% decrease in investment purchases, cutbacks in the labor force due to business not being able to sell anything, and a downturn in consumer spending.

Thus, due to a mixture of socio-economic and industrial wealth inequality, high tariffs on foreign imports, a stock market bubble, and poor economic management by the Federal Reserve, the United States descended into the Great Depression.

Initially, in the onset of the Depression, then-President Hoover decided against the government taking action to help individuals on the grounds that "if left alone the economy would right itself and argued that direct government assistance to individuals would weaken the moral fiber of the American people." [14] However, when he was forced by Congress to intervene in the economy, Hoover focused his "spending [on stabilizing] the business community, believing that returning prosperity would eventually 'trickle down' to the poor majority," [15] and thus began the first implementation of what would later be called in the '70s, "trickle-down economics."

The public, being appalled by the lack of empathy from Hoover, voted Franklin D. Roosevelt (FDR) into office. Once in office, he began embarking on programs that would come to be known as "The New Deal." However, this was not a deal concerned with easing the pain of the Depression on ordinary people, rather FDR "sought to save capitalism and the fundamental institutions of American society from the disaster of the Great Depression."

[16] While the popular view is that the New Deal was radically different from Hoover's plan, in reality the two plans didn't truly differ to much as while some social programs were implemented, overall FDR's plan "tended toward a continuation of 'trickle down' policies, albeit better-funded and executed more creatively." [17]

He never truly adopted Keynesian economics, which argued that the "government should use its massive financial power (taxing and spending) as a sort of ballast to stabilize the economy." [18] This can be seen in the Agricultural Adjustment Act which paid farmers to produce less, however, this "did little for smaller farmers and led to the eviction and homelessness of tenants and sharecroppers whose landlords hardly needed their services under a system that paid them to grow less" [19], while also not addressing the main problem of the Depression: weak consumer spending. Overall, the Act benefited mainly moderate and large agriculture operations. Another example is the National Industrial Recovery Act. The National Industrial Recovery Act encouraged industries to avoid selling below cost to attract more customers, and while this was good for businesses in the short run, it "resulted in increased unemployment and an even smaller customer pool in the long-run." [20] FDR's overall goal, while he did aid in the creation of social programs such as Social Security and enacted many jobs programs, was to protect capitalism and the very institutions that led to the Great Depression.

Another topic that isn't even mentioned in examinations of the Great Depression is the Depression's effect on home mortgages. During the 1920s and early 1930s, the US experienced a housing boom, whose peak was around 1924 for single-family houses and 1927 for multi-family houses.[21] In 1928, when the Fed began cracking down on speculation, housing investments began to fall due to the sharp increase in interest rates. Housing debt had "increased rapidly during the 1920s and continued to grow even after housing starts had begun to decline and house prices had leveled off" [22] and due to deflation, housing debt continued to increase until 1932. While rising debt usually doesn't pose a problem for households as long as they could make their loans payments, yet household incomes and wealth decreased greatly during the Depression, thus leading "loan delinquencies and foreclosures [to soar], fueled by falling household incomes and property values." [23] It was extremely difficult for homeowners to keep their property as "Falling incomes made it increasingly difficult for borrowers to make loan payments or to refinance outstanding loans as they came due." [24] However, the situation would improve as unlike the experience with the financial industry, the government stepped in to remedy the situation with the creation of agencies such as the Federal National Mortgage Association and the Federal Home Loan Bank System which aided homeowners in financing their mortgages.

Unlike the Depression, where falling mortgages were a side effect of the overall economic crash, in this current recession, mortgages played a major role in facilitating a near collapse of the global economy. Ordinary Americans found themselves able to purchase homes as credit was easily available. Yet due to predatory lending on the part of banks, the majority of these houses were being bought by people who couldn't afford them and many homeowners would soon find themselves having underwater mortgages due to "one-year adjustable –rate mortgages (ARMs) with teaser rates for first 2-3 years of a mortgage" which "were set artificially low and then reset much higher." [25] Due to credit rating agencies lowering the requirements for having mortgages rated AAA, the majority of these mortgages "were packaged into opaque securities and sold to public" and this "Subprime loans increased from 9% of new mortgage originations in 2001 to 40% in 2006." [26] Yet at the

end of 2006, events took a turn for the worse as mortgage payments decreased and with it the value of mortgage-backed securities.

The mortgage bubble burst left in its wake “destroyed household savings in the ensuring financial meltdown, forcing individuals to slash their spending,” [27] which led to a massive decrease in consumer spending and a long, painful recession. The housing bubble burst also had larger consequences as “The disappearance of cushion against future losses virtually froze the credit market.” [28] In addition to this, several large financial institutions such as Lehman Brothers and Bear Stearns collapsed, thus prompting the government to intervene, though not on the behalf of the American people.

Just as in the Great Depression, the US government’s main goal was to protect the very institutions that caused the financial crisis instead of dealing with them. There were cries from leaders of the financial and political elite that massive companies such as AIG were “too big too fail,” thus the US government embarked upon a $700 billion bailout. However, the true cost of the bail out is more like $839 billion as

the $700 billion [was] in addition to an $85 billion agreement on a bailout of the insurance giant American International Group, plus $29 billion [was] support that the government pledged in the marriage of Bear Stearns and JPMorgan Chase. On top of all that, the Congressional Budget Office [said] the federal bailout of the mortgage finance companies Fannie Mae and Freddie Mac could cost $25 billion. [29]

This money was paid to the corporations by the US taxpayer. While the financial institutions stated that they needed to money to survive, once gotten, corporations used to bailout money to stabilize their corporations, but also to hand out massive bonuses to corporate executives. [30] This bailout did not address the root causes of the financial meltdown: incompetence of the US government in regulating the financial industry, massive financial speculation, and predatory lending.

As they had during the Depression, the Federal Reserve played a role in bringing about the recession. Their main goal was to try “to artificially prop up those markets [of bad debt and worthless assets] and keep those assets trading at prices far in excess of their actual market value.” [31] To this end, the Fed provided $16 trillion to domestic and foreign banks in the form of secret loans and bought mortgage-backed securities that were in reality, completely and totally worthless. [32] In addition to this, many of the people on the board of directors at the Federal Reserve also had connections to corporations that received bailout money.

For example, the CEO of JP Morgan Chase served on the New York Fed’s board of directors at the same time that his bank received more than $390 billion in financial assistance from the Fed. Moreover, JP Morgan Chase served as one of the clearing banks for the Fed’s emergency lending programs.

In another disturbing finding, the GAO said that on Sept. 19, 2008, William Dudley, who is now the New York Fed president, was granted a waiver to let him keep investments in AIG and General Electric at the same time AIG and GE were given bailout funds. One reason the Fed did not make Dudley sell his holdings, according to the audit, was that it might have created the appearance of a conflict of interest. [33] (emphasis added)

Thus, there was a very cozy relationship between the Federal Reserve and the banks that

received bailout funds. This only serves to show the revolving door relationship between the two groups and how the Fed's actions were subject to the interests of the large banks.

However, these are not the only actions the Fed took that helped to create the financial crisis. Their role goes back even further, almost a decade. In the early 1990s, Congress played a large role in trying to increase the amount of homeowners by passing the Home Ownership & Equity Protection Act of 1994 (HOEPA), which planned to address concerns of "reverse redlining" which was"the practice of targeting residents of specific disadvantaged communities for credit on unfair terms, and in particular by second mortgage lenders, home improvement contractors, and finance companies." [34] To achieve these ends, the Act called for the establishment of residential mortgage loans which were fixed so that it would be easier for low-income home owners to repay their loans. The Act also gave the Fed the ability, not only to ensure that HOEPA was carried out, but also to

exempt specific mortgages or categories of mortgages from any or all of the HOEPA requirements, or prohibit additional acts or practices in connection with any mortgage (not just "high cost mortgages") that the Board determines are unfair, deceptive, or designed to evade HOEPA, or that are made in connection with a refinancing of a mortgage loan that the Board finds to be associated with abusive lending practices, or that are otherwise not in the interest of the borrower. [35]

However, then-Fed Chairman Alan Greenspan refused to curb predatory lending as he touted a kind of laissez-faire economics and argued that the market would take care of itself. This refusal to attack predatory lenders would come back in later years in the form of the current financial crisis.

Many thought that with the election of Barack Obama, he would fulfill his much touted goals of "hope and change" to restore the US, yet this did not occur with America's foreign policy, nor did it occur with America's economic policy. Obama's economic team consisted of former Treasury Secretary Robert Rubin who was the "chairman of Citigroup Inc.'s executive committee when the bank pushed bogus analyst research, helped Enron Corp. cook its books, and got caught baking its own" and also "was a director from 2000 to 2006 at Ford Motor Co., which also committed accounting fouls and now is begging Uncle Sam for Citigroup- style bailout cash." [36] Two former Citigroup directors, Xerox Corp. Chief Executive Officer Anne Mulcahy and Time Warner Inc. Chairman Richard Parsons, were appointed to his economic team. Both Mulcahy and Parsons have shady pasts as not only were "Xerox and Time Warner got pinched years ago by the Securities and Exchange Commission for accounting frauds that occurred while Mulcahy and Parsons held lesser executive posts at their respective companies," [37] but both were directors at Fannie Mae when that company was breaking accounting rules. To round out the group, former Commerce Secretary William Daley was appointed and at the time of his appointment, Daley was "a member of the executive committee at JPMorgan Chase & Co., which, like Citigroup, is among the nine large banks that just got $125 billion of Treasury's bailout budget." [38] Thus, it was no surprise to anyone who was paying close attention to the financial crisis and Obama's economic team that instead of attacking the root causes of the crisis, instead these advisors opted for a massive stimulus package of almost $800 billion. The situation had long been one where the patients were running the asylum.

While the stimulus undoubtedly saved millions of jobs, it didn't fulfill its main objective: stimulate the economy. The debt ceiling debacle would serve to only make the situation worse as the Republicans wanted solely austerity measures implemented and the

Democrats capitulated, almost without a fight. Both parties began to create in the public's mind the idea that the only way to rein in the deficit was for austerity measures to be implemented. However, these austerity measures will only serve to exacerbate the situation as the IMF stated that implementing austerity measures "will hurt income in the short term and worsen unemployment in the long term." [39] Thus, the $2 trillion that the government plans to cut in social programs will only serve to make an already horrid situation even worse.

Currently, America's fiscal situation is in tatters. While the stock market is doing well, the real problem is unemployment, which is on a level that hasn't been seen since the Great Depression [40] and things are not going to get better soon. This becomes a serious problem as without employment, people don't have money to spend and America's economy "is predominantly driven by consumer spending, which accounts for approximately 70 percent of all economic growth." [41] (emphasis added)

Another Depression is possible due to the fact that while things may seem to have calmed down for now, the deep, structural problems within America's economy still exist, are still active and therefore still have the potential to do major damage in the future. Economist Nouriel Roubini stated that another crisis is already manifesting itself in developed nations. [42] The only thing that the bailouts served to do was delay the inevitable: the bailed out corporations will fail due to their own risky practices and they will bring the US and world economies down with them.

Notes

1: http://www.gusmorino.com/pag3/greatdepression/index.html
2: Ibid
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