

# Reaction to the assessment of A.W. Mullineux

The comment correctly summarizes my conclusion, that the Current Crisis had the potential to become a larger crisis, and that economic policy (together with a larger share of services and of Asian countries contributing to the world economy) prevented this. The comment highlights that some of the conclusions might be "premature". I think I am rather careful of this. My overall assessment is that -although we currently see a lot of turmoil and unsolved problems - the likelihood of a decline in world output in 2011 is very small (lower growth rates relative to 2010 may come, and some countries may have negative GDP growth also in 2011).

The Great Depression was that long, since problems occurred in a sequence (or in stages). This time three of these stages occurred in the first year: the breakdown of stock markets, that of international trade, and bank failures. In the Great Depression in between these "stages" small recoveries were to be seen and people remained optimistic in general, few people expected or predicted a long crisis. This time round many economists predicted a long and protracted crisis similar to that in the thirties in late 2008, and most of them were reluctant to accept the green spots as of spring 2009 as signs of recovery. And now some indicators (not all) have reached pre crisis levels. Specifically the world economy is forecast to grow at 3% to 4% in 2010, which would make up for much more than the GDP loss in 2008/09 (on the world level, not for Europe, by far not for many badly hit countries). World GDP during the Great Depression never recovered pre-crisis level.

If now a second world-wide wave would come, it would have very different causes as compared to the second and third wave in the thirties. A new crisis could be triggered by unsolved disequilibria, the non reformed financial sector, the burst of the Chinese construction bubble, and from bad exit strategies. During the GD the second and third waves came from effects of a cumulative contraction of demand, including bank failures and the gradual break down of exuberance.

I fully agree with the caveats presented in the comment with regard to exit strategies and structural problems.

Fiscal retrenchment should not be too aggressive, nor should it start too quickly. This is important for the countries with a rather good history in fiscal policy like Germany (and Germany is not too eager to balance its budget -the ruling parties are currently discussing which tax to decrease and by what amount). It is important for the southern countries (Greece, Portugal, Spain), that they commit to deficit reduction earnestly, but not try to go from double digit deficits to zero while Europe grows at less than 2%.

As far as the relative low increase in unemployment is concerned, I agree that part time work has been one of the reasons for the slow reaction of unemployment to lower production. This may be a problem, since what goes up slowly might than prove more persistent. Unemployment always lags output, consequently for this indicator I included data for 2010 in my comparison (in contrast to the other indicators). However, unemployment did not accelerate recently, but has flattened off. This may be due to lower increase in population in working age or less pressure by immigration (which might be a problem in the longer run).

I agree with the higher potential for a crisis from the larger capital flows, with the skeptical remarks regarding a bank tax in a period where banks need more capital (I would prefer a financial transaction tax). And I am quite sure that there are limits to Keynesianism, since crowding out might occur. But a small amount of crowding out is to be much preferred to over liquidity due to spirals of falling consumption and investment demand.

It is always difficult to decide, at which time to take stock. If you know everything about the origin, the proliferation, the policy reaction to the crisis and its short and long run effect, it is too late to write an interesting paper. The article was started at a time where many of the best economists claimed that the crisis was or could become as deep as the Great Depression (specifically the homepage of Eichengreen, O'Rourke, presenting the best quantitative evidence on the evolvement of the crisis, did this for about a year). Now we know this did not happen since recovery started in mid or late 2009. And if policy and institutions work in the exit phase well, a second step of the same crisis will not occur soon. On the other hand problems in the aftermath of the crisis exist and the problems that led to the crisis are not resolved. Mainstream Keynesianism cannot solve problems, which come from insufficient institutions, structures, trade. This is in line with the last sentence in the comment.

Karl Aiginger, April 8 2010