Open Assessment of:

The Great Recession versus the Great Depression: Stylized Facts on Siblings That Were Given Different Foster Parents.

This paper examines stylized facts on 10 'industrial economics' i.e. the USA, Japan, the UK, Germany, France, Spain, Sweden, Finland, Austria and Belgium. It comes to the conclusion that the Great Recession (GR) had the potential to become a second Great Depression (GD), but that 'Keynesian' fiscal and monetary policies, and restraint with regard to the introduction of protectionist trade policies and the significant increase in the relative importance of the, largely non traded, services sector since the 1930s prevented it from doing so.

In sum, we are all 'Keynesians' now, thank goodness, or are we? Is the paper's conclusion too quickly drawn? The Great Depression, in the US at least, was a 'double dip' affair, in part because of a premature withdrawal of fiscal stimulus, and Japan too suffered from premature tightening during the 'lost decade' after the collapse of its bubble economy in 1990. Since the paper was published, Greece has come under pressure to instigate 'fiscal consolidation'. Spain and Portugal and Italy and the UK, and even the US, could feel the pressure before long. Economists are divided on the issue of how soon and how fast fiscal consolidation, and a return to monetary rectitude, should progress, and so too, of course, are politicians.

There is a risk that if fiscal retrenchment and monetary tightening is undertaken too aggressively too soon, a second dip could result and then the author would have to re-assess the situation. Should the central banks hold back from monetary tightening, or will this just let the governments off the hook and add to the moral hazard/'too big to fail' problems in the banking sector; and what of 'leaning against the wind' with respect to asset price inflations? It seems ironic that the 'markets' (i.e. the banks and other major financial actors) are pressing for fiscal consolidation when it is they in fact who precipitated the spike in fiscal deficits in the first place!

The paper notes that the rise in unemployment in the GR, in Europe in particular, has been much less marked than in the GD. Unemployment is well known to be a lagging indicator and in some countries, particularly the UK and Germany (due to a special government scheme) part time working has increased significantly. Once the recovery is established, many part time workers may in fact lose their jobs in the UK, whilst others will revert to full time work. And if a second dip occurs, many more part time workers are likely to lose their jobs.

The paper also notes that 'automatic stabilisers' work more strongly in Europe, due to its more prominent 'welfare states', than in the US; which has had to rely more heavily and direct fiscal stimulus packages. The UK and Germany, like the US, introduced 'cash for clunkers' old car (automobile) replacement schemes and the UK cut Value Added Tax (a consumption tax) from 17.5% to 15% for a period of twelve months or so to stimulate consumption.

It should also be noted that the financial sector and international capital flows are proportionately larger than in the 1930s and so the potential for contagion was greater. The 'synchronisation' of business cycles seems to have been greater amongst the 'industrial countries' than the 'developing countries', however. China, the ASEAN countries and Brazil seem to have had a rather good 'Global Financial Crisis', it should be noted! Indeed their countervailing performance may have helped significantly in preventing the GR turning into a second GD (although China's reluctance to revalue its currency is arguably the global imbalance that contributed most significantly to causing the crisis and it has yet to be resolved!).

Another reason to believe that the author is perhaps too sanguine is that any increase in the 'regulatory tax' on banks as a result of their re-regulation, if it ever comes about, will reduce bank lending and make it more expensive. Along with fiscal consolidation, this will create a drag or growth. The 'capital markets' might conceivably fill the space left by banking (unless investment banks and the shadow banking sector are subject to similar regulatory taxes), but the large issuance of government bonds is bound to have a 'crowding out' effect. Perhaps there are limits to 'Keynesianism' after all!

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