Chapter 4

Similarities and Differences

The chapter focuses on the similarities and differences between the two crises and provides a detailed account of the Roosevelt and Obama administration in tackling the crises. The monetary and fiscal policy measures are highlighted and the role of these measures in averting and also in accelerating the crises.

The first item on the agenda of Roosevelt administration was the banking sector reforms during the great depression and the Obama administration stressed with the Fed making sure that the 19 Wall Street banks are in good health as part of its policies. One third of the banking assets in the finance sector were bought by the Reconstruction Finance Corporation which was worth $1 billion during the Great Depression. Out of the total of $700 billion, $250 billion were run into by the Wall Street banks when the Asset Relief Program funding was in trouble. Vast amounts of subprime mortgages were supported by the Treasury to Fannie Mae and Freddie Mac when the Roosevelt program of bailing out American home owners became manageable. To avoid foreclosures and refinance the home owners’ homes, the Home Owners’ Loan Corporation was established. Lenders and investors took losses for the mortgage holders to afford their mortgages. 80% were saved and 200000 owners defaulted. Originally held by Fannie and Freddie, the subprime mortgages were running a loss of $5.5 trillion out of an estimated total of $10 trillion. As part of the New Deal, in 1936 the public works program reduced unemployment from 25% to 14%. The Congress in 2009 announced a package of $862 billion to influence on employment and output in the US
economy. The benefit of the package was the reduction in recessionary GDP decline and unemployment due to the continuation of the stimulus package until 2011. Compared to the current crisis, unemployment and output loss which has been higher incomparably. More than the current crisis, the flow of Dollar for Dollar rate was speedy in 1930s as part of the economic benefit from the stimulus. By building schools, roads and bridges the New Deal public works program provided the impetus of growth. In engineering technology, public-private coordination, constructions know how, organization the result of the New Deal was less pronouncing. The New Deal program was successful in generating employment in its mission of rapid employment program. Compared with the Great Depression, in the current crisis there is a requirement for upgrading demands such as superior training and advanced skills. Regarding the Great Depression and Great Recession, monetary and fiscal policies were similar and different as well.

4.1 Monetary and Fiscal Policies
The counterproductive and conservative fiscal and monetary policies of the 1920s and 1930s kept the US economy in deflation due to significantly low growth rate of money supply. During the recovery of 1936-37, the Fed raised reserve requirements of commercial banks in 1937. In retaining profits of businesses and cut back through higher taxes the budget deficit turned out to be counterproductive. The conservative fiscal policy of Roosevelt continued. Keynesian pump priming was not fully observed by Roosevelt. But it was expansionary policy adopted in the current crisis. Debates were conducted on the cut back of public debt to GDP ratio in the budget deficit of 2009 and 2010. Federal funds were maintained at close to 0 percent and the Federal Reserve
released more cash by the purchase of long term Treasury Bonds. Rather than the loans to business, the US banks emphasized on retail buying of loans by the customers. According to Galbraith (1954) in 1937, there was a hasty tightening of monetary and fiscal policies in the midst of a fragile recovery with high unemployment providing a major lesson for policy makers in managing the current recession with slow GDP recovery prospects and an unemployment rate of 9.6 percent of the labor force. From the current expansion, there was a temptation of a premature monetary and fiscal tightening to the next level of monetary expansion. There was a number of government agencies created to deal with the Great Depression. The creation of the Dodd-Frank Act which became part of the regulatory over haul was no less impressive. Among the government agencies created by the New Deal are the Federal Deposit Insurance Corporation, Social Security Program and The Securities and Exchange Commission. For years these institutions continued to create mixed operational records. In the bail out the FDIC financial resources small and medium banks were bailed out providing subprime mortgages. The trading of highly leveraged securities, the credit rating of SEC was tracked down which is positively rated. The social security program contributed to the federal budget deficit by cash outflows in excess of inflows. The Obama administration medical insurance was not that successful compared to the New Deal arrangement for promoting welfare of the retirees. The bureau created to consider consumer interests in mortgages and credit card issues regulated by the Consumer Financial Protection Bureau. The effective implementation of this Dodd Frank Act prevents the consumers from a crisis. The need of the hour is to implement them effectively. Trade, technology and finance are more interactive and networked in the
current crisis compared with the 1930s cross border trade. Policy making around the world have complicated their policy making based on the role of China as a creditor in US Treasury debt and an aggressive enforcer of its exchange policy. As mentioned by John (1978) regarding monetary and fiscal policy in the 1930s the decisive factor was the American European interaction. Gold inflows and gold outflows were the relevant interactions. The monetary policy choices of United States were complication by the gold standard issues. European banking sector and the European Union were badly affected in the current crisis. Euro faced a weakened currency status due to the fiscal mismanagement by some of the European Union members. Drastic consequences of the 1930s Depression were guided by political instability which led to the Second World War destabilizing the European economic environment while in the current crisis the impact on European Union was less pronounced. The consequence of World War II for the United States was that it came out of the Great Depression as a result of weapons trade. The unemployment rate in the United States was 17.2 percent and by 1945 2 percent drop happened in unemployment. Around 10 to 15 million workers produced military items from bullets to tank at home and 10 to 12 million soldiers who went abroad for war generated a temporary employment situation. The output from manufacturing went up to 50% from the period from 1939 to 1941. A massive improvement in productive capacity happened due to the liberal corporate policy. The slash from 90% to 38 percent of the corporate tax policy the GDP doubled from 1940 to 1945. There was a boom situation in the country. Income over $ 200000 was taxed as part of the income tax rate which was slashed from 9.4% to 86.4%. Around 12 million Americans were exempted from tax rolls entirely. The similarity with the current crisis
lies in the United States engaging in two wars with a continued Iraq operation. The federal budget developed a significant burden due to these continued wars. As discussed by Eggertsson, (2008) compared to the war economy growth in 1940s, the current crisis is dominated by a burden or debt situation unlike the Post World War II scenario. The political situation then and now are different and the difference in political environment today and the Roosevelt administration which provided the post war recovery needs to be analyzed. The political environment during the Roosevelt administration was no less contentious than under Obama. The ideological battles ruled the Great Depression period and the Left believed that the New Deal was not going as far as expected. The Republicans believed that the new taxes and the institutional over haul will harm American as the belief even now. They believed that Roosevelt was not different from Stalin or Mussolini and considered the New Deal as un-American. The criticism against Obama is that he acts like a Socialist. Both Roosevelt and Obama spoke for the common man and the Roosevelt changed his position when it was required. But in the case of Obama, he is not into the living rooms of the common man as the radio talks of Roosevelt did in 1930s. There is a need for the Obama administration to raise to the expectations of the American public and deliver results.

The crash of 1929 was the immediate cause for the Great Depression of 1930s which by the end of the roaring twenties which initiated bank and business failures devastated housing finances and resulted in massive unemployment. It was the housing boom which caused the current financial crisis, fed by the Federal Reserve’s liberal monetary policy which started in 2001. The lax regulatory set up resulted in excessive mortgage buildup by Americans. They were subprime mortgages as it turned out to be
by 2007. When Freddie Mac and Fannie Mae took over the worthless mortgages of the Wall Street, massive debts and banks were rescued temporarily by the end of 2007. In mid 2010, investment cutbacks by businesses led to rising unemployment which was 9.6 percent. The cause of origin of the Great Depression was the stock market collapse in 1929 which continued through 1930 to 1932. In the current financial crisis the housing boom in an environment of easy monetary policy and lax regulatory environment initiated the crisis. Therefore the origins were different. The growth of real GDP fell to -2.73 percent in 2008 but the decline during the Great Depression was -23 percent. In the Obama administration unemployment was 10.1% in 2009 but in 1933 it was 25% of unemployment. The inflation rate in the latter was as low as -12 percent in 1938. The lowest during the current crisis was -1.93 percent in 2009. Finally the stock market plunge of 90 percent from 1929 to 1932 was more severe than the decline of 48% from 2007 to 2009. The reason for the current crisis to be called Great Recession is that the impact on the economy was moderate during this crisis.