

Financial meltdown brings new challenges

COLIN READ, Everybody's Business

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— First, it was the worst economic downturn since 2001. As the recession deepened, they said it may be as deep as the recession of 1991. Soon it was compared to 1980-82, and then 1973-75. Now this is the worst recession since the Great Depression. President Obama even stated that conditions could be worse than that.

I just hope we don't soon start comparing the crisis to the Black Death.

Obama is correct in a way. This Great Recession has more challenges than the Great Depression.

The difference is in the dynamics.

Over the last 22 months, our unemployment has risen from 4.4 percent to nearly 8 percent. Let's put this into historical perspective of other periods when unemployment ballooned.

Following the mammoth WWII buildup and subsequent peacetime loss of military jobs, the unemployment rate rose from 4 percent to 8 percent in 19 months. This post-war increase in unemployment and inflation in 1948 is not uncommon following major wars, and is often temporary. By the end of the decade, the labor force had stabilized. The transition may have been challenging socially, but not economically.

Just five years later, unemployment again shot up, from 2.5 percent to 6 percent in 16 months as G.I.s returning from Korea had to be reabsorbed into the labor force. While some pessimism set in, economic misery did not.

By 1957, the unemployment rate had stabilized at 3.5 percent, only to shoot up again to 7.5 percent in 16 months on the heels of decreased global demand. Automobile production fell at the greatest rate since the manufacturing diversion of World War II, a rate only recently exceeded. While sharp, this recession also ended quickly.

The most severe downturn in the post-WWII era began in 1974. In the wake of the OPEC oil crisis, the unemployment rate went from 5 percent to 9 percent in 16 months. A dramatic shift in wealth from the U.S. to oil-producing nations meant that our piece of the economic pie needed to shrink. Misguided efforts to protect us from this inevitable diversion of wealth abroad caused prices to rise and inflation to become chronic for the balance of the decade.

While printing money kept incomes artificially high, it also forced inflation to almost 14 percent by 1980, a level not seen at any time in the century except for the dramatic and temporary inflations following World Wars I and II. Cost-of-living allowances forced inflation to be institutionalized, necessitating draconian monetary tightening that resulted in a rise of unemployment from 6 percent in 1980 to 10.5 percent three years later. The economy did manage to stabilize eventually, and heralded in two decades of relatively pain-free economics.

While many of us still recall the displacements of the period from 1973 to 1984, we do not remember widespread economic suffering. The nation was like the frog in a pan of water that was only slowly getting hotter. Economic displacement was sufficiently gradual that most were able to adjust without great unease. Banks and financial markets did not crash. And monetary policy and rising wages insulated us instead of motivating us to reinvent ourselves from the obsolete days of K-cars. Instead, we bailed out Chrysler.

We are still a long way from the 15-percentage-point increase in unemployment that occurred from 1930 to 1932. Then, half a decade of dramatic growth, from 1923 to 1928, gave pause for concern well before the Great Crash in 1929. The excesses of the Roaring Twenties led to a tripling of farmland production from 1925 to 1930, while manufacturing overproduction created dangerously high inventories in 1928 and 1929. These overproductions caused a dramatic decline in goods prices and a collapse in farm prices in 1930 that contributed to the Dust Bowl from 1930 to 1935.

Rising inventories, a commodities bust, and runs on banks each rivaled the 1929 financial crash in significance. The Great Depression occurred as a consequence of a confluence of forces, worsened by benign and ideological neglect of the Hoover Administration from 1928 to 1932. At that time, government was very small and was neither a large contributor to the problem nor the solution.

While we seem to remember the Great Depression as intense and calamitous, its first year was not very dramatic. Indeed, the stock market was almost fully recovered a year after the Great Crash.

Today's overcapacity, a big run up and subsequent collapse of commodity prices, and lack of faith in the banking industry, all bear eerie resemblances to the Great Depression. Our banking industry did not fail this time because of New Deal-era banking regulation and insurance reforms. On the other hand, more wealth was wiped out more rapidly in this crisis than in the first year or two of the Great Depression.

Compounding the problem is our delay in market reforms for almost 35 years now. Have we learned? After all, the intensity and unease of this crisis is different. One cannot listen to the news for more than a few minutes without hearing reference to painful stories. It is the velocity of increasing economic misery that is new and scary.

For instance, I expect the unemployment to rise to nearly 8 percent for February. The rate will have risen by three percentage points in 10 months. If it further rises to 9 percent by April, this rise of four percentage points will be the fastest run-up since the Great Depression. It seems likely that the new stimulus package will not be able to arrest unemployment growth quickly enough.

The biggest difference now is that we have 51 large governments across the nation, and only one of those is determined to stimulate the economy as a matter of policy. And spend it shall, overshadowing by a factor of three the real rate of federal spending in the New Deal.

If states perform massive layoffs, the coordination failure could bring us down significantly further. On the other hand, if states refuse to reinvent themselves from the bloated excesses of better days, they will be the new Chryslers and General Motors of the next few decades.

Our success will be measured by our ability to coordinate the rescue. We know more now. Only time will tell if we also have greater wisdom.

Perhaps the greatest parallel for which we can hope is to remember what has happened so economic history does not repeat itself — just as two generations following the Great Depression remembered.

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