

## A Tale of Two Depressions

By Barry Eichengreen and Kevin H. O'Rourke \*

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*Often cited comparisons – which look only at the US – find that today's crisis is milder than the Great Depression. In this column, two leading economic historians show that the world economy is now plummeting in a Great-Depression-like manner. Indeed, world industrial production, trade, and stock markets are diving faster now than during 1929-30. Fortunately, the policy response to date is much better.*



Kevin H. O'Rourke

The parallels between the Great Depression of the 1930s and our current Great Recession have been widely remarked upon. [Paul Krugman](#) has compared the fall in US industrial production from its mid-1929 and late-2007 peaks, showing that it has been milder this time. On this basis he refers to the current situation, with characteristic black humour, as only “half a Great Depression.” The “[Four Bad Bears](#)” graph comparing the Dow in 1929-30 and S&P 500 in 2008-9 has similarly had wide circulation (Short 2009). It shows the US stock market since late 2007 falling just about as fast as in 1929-30.

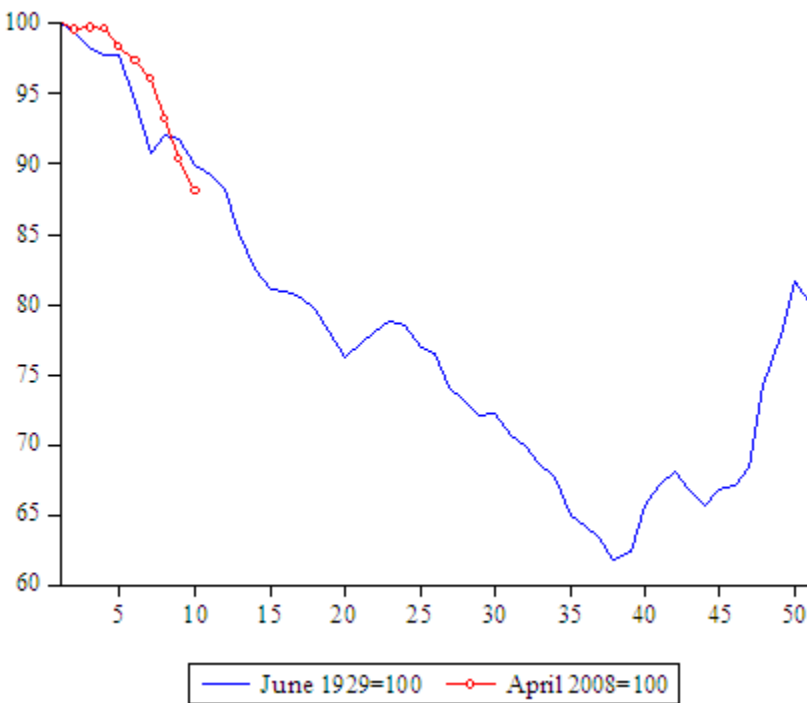
### **Comparing the Great Depression to now for the world, not just the US**

This and most other commentary contrasting the two episodes compares America then and now. This, however, is a misleading picture. The Great Depression was a global phenomenon. Even if it originated, in some sense, in the US, it was transmitted internationally by trade flows, capital flows and commodity prices. That said, different countries were affected differently. The US is not representative of their experiences.

Our Great Recession is every bit as global, earlier hopes for decoupling in Asia and Europe notwithstanding. Increasingly there is awareness that events have taken an even uglier turn outside the US, with even larger falls in manufacturing production, exports and equity prices.

In fact, when we look globally, as in Figure 1, the decline in industrial production in the last nine months has been at least as severe as in the nine months following the 1929 peak. (All graphs in this column track behaviour after the peaks in world industrial production, which occurred in June 1929 and April 2008.) Here, then, is a first illustration of how the global picture provides a very different and, indeed, more disturbing perspective than the US case considered by Krugman, which as noted earlier shows a smaller decline in manufacturing production now than then.

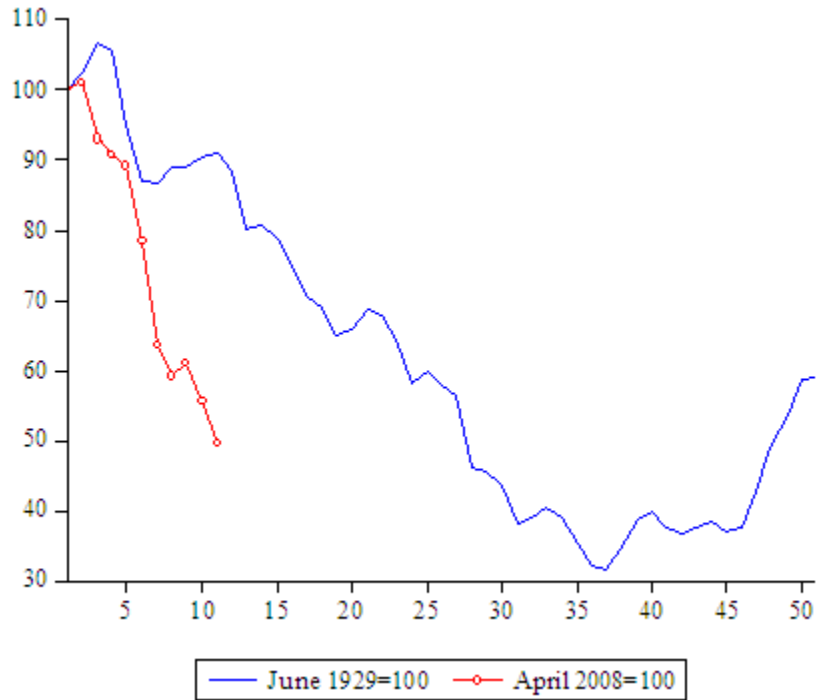
**Figure 1.** World Industrial Output, Now vs Then



Source: *Eichengreen and O'Rourke (2009)*.

Similarly, while the fall in US stock market has tracked 1929, global stock markets are falling even faster now than in the Great Depression (Figure 2). Again this is contrary to the impression left by those who, basing their comparison on the US market alone, suggest that the current crash is no more serious than that of 1929-30.

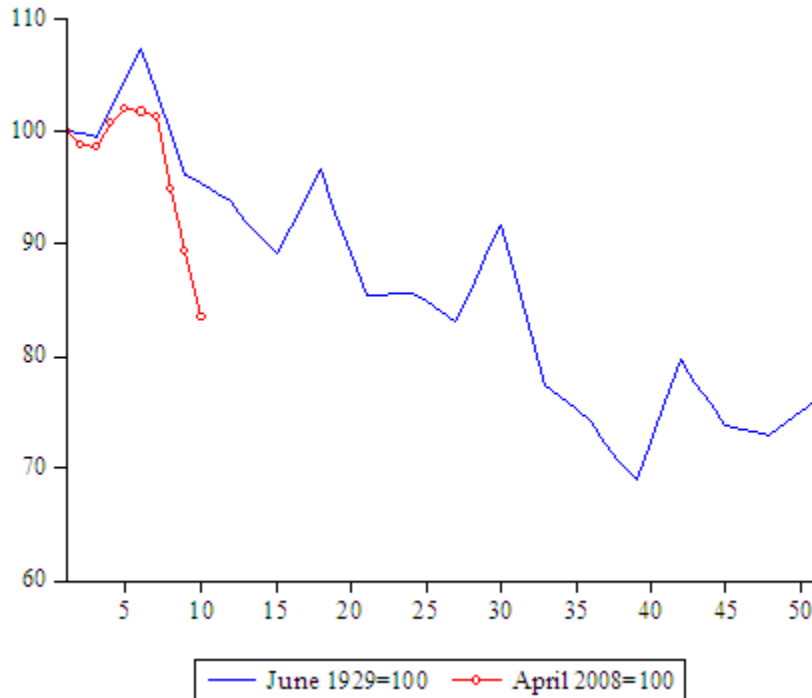
**Figure 2.** World Stock Markets, Now vs Then



*Source: Global Financial Database.*

Another area where we are “surpassing” our forbearers is in destroying trade. World trade is falling much faster now than in 1929-30 (Figure 3). This is highly alarming given the prominence attached in the historical literature to trade destruction as a factor compounding the Great Depression.

**Figure 3.** The Volume of World Trade, Now vs Then



Sources: [League of Nations Monthly Bulletin of Statistics](#)

### It's a Depression alright

To sum up, globally we are tracking or doing even worse than the Great Depression, whether the metric is industrial production, exports or equity valuations. Focusing on the US causes one to minimise this alarming fact. The “Great Recession” label may turn out to be too optimistic. This is a Depression-sized event.

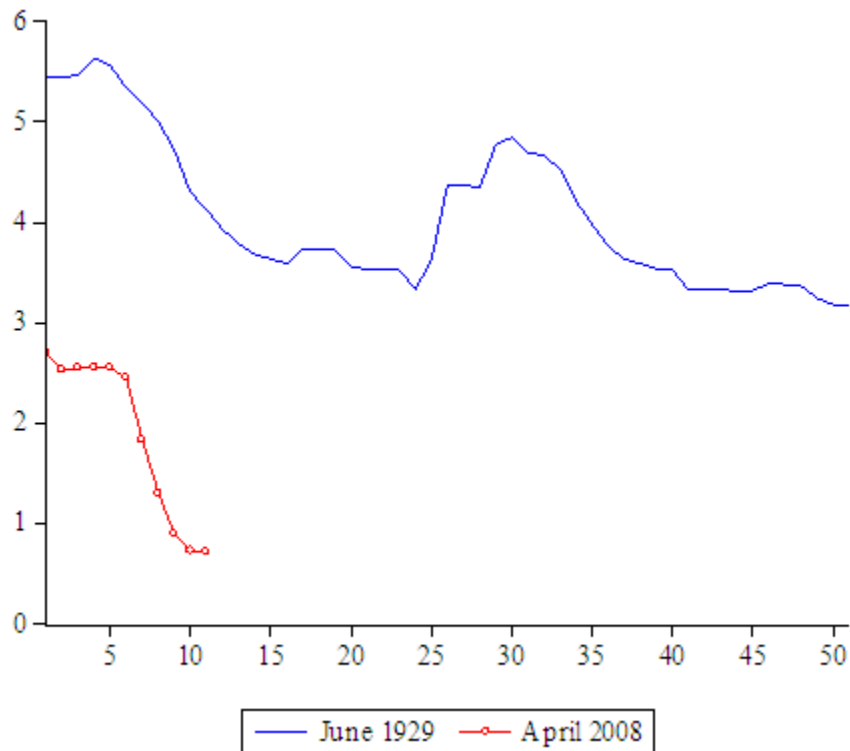
That said, we are only one year into the current crisis, whereas after 1929 the world economy continued to shrink for three successive years. What matters now is that policy makers arrest the decline. We therefore turn to the policy response.

### Policy responses: Then and now

Figure 4 shows a GDP-weighted average of central bank discount rates for 7 countries. As can be seen, in both crises there was a lag of five or six months before discount rates responded to the passing of the peak, although in the present crisis rates have been cut more rapidly and from a lower level. There is more at work here than simply

the difference between George Harrison and Ben Bernanke. The central bank response has differed globally.

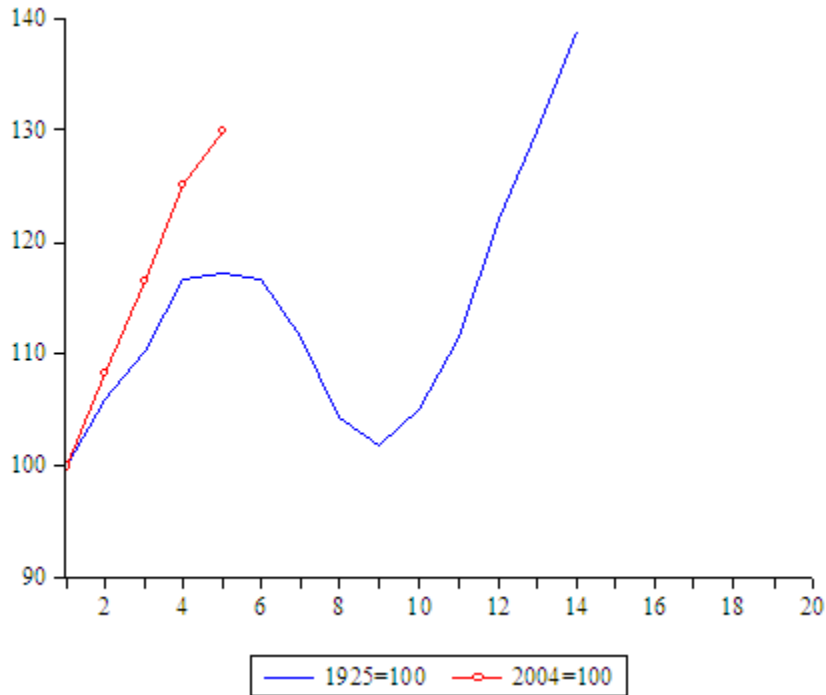
**Figure 4.** Central Bank Discount Rates, Now vs Then (7 country average)



*Source: Bernanke and Mihov (2000); Bank of England, ECB, Bank of Japan, St. Louis Fed, National Bank of Poland, Sveriges Riksbank.*

Figure 5 shows money supply for a GDP-weighted average of 19 countries accounting for more than half of world GDP in 2004. Clearly, monetary expansion was more rapid in the run-up to the 2008 crisis than during 1925-29, which is a reminder that the stage-setting events were not the same in the two cases. Moreover, the global money supply continued to grow rapidly in 2008, unlike in 1929 when it levelled off and then underwent a catastrophic decline.

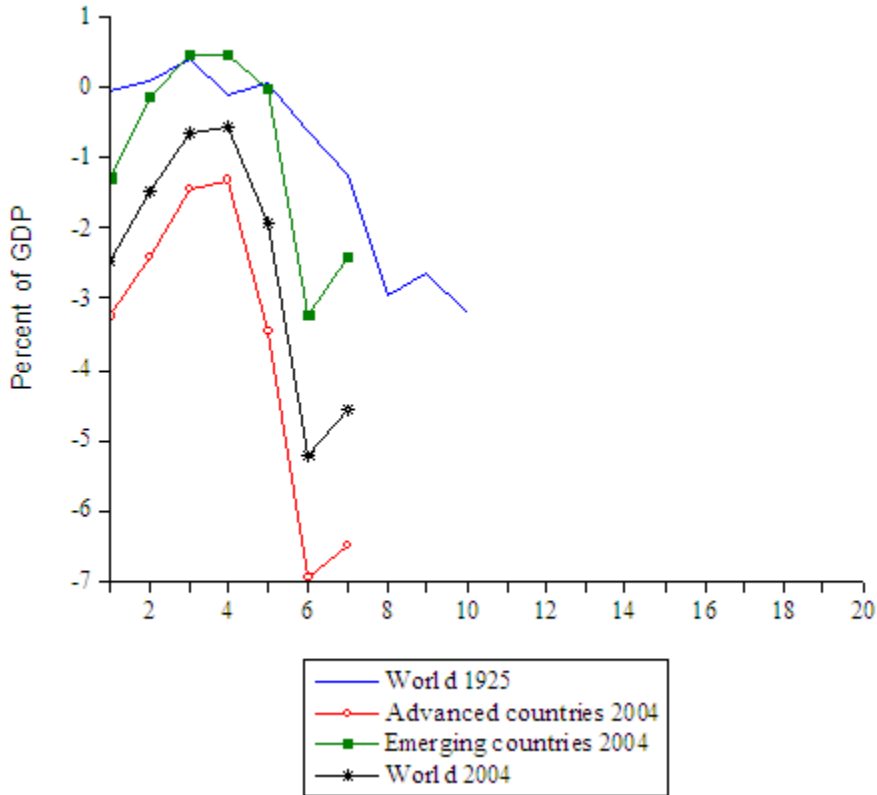
**Figure 5.** Money Supplies, 19 Countries, Now vs Then



Source: Bordo et al. (2001), *IMF International Financial Statistics*, *OECD Monthly Economic Indicators*.

Figure 6 is the analogous picture for fiscal policy, in this case for 24 countries. The interwar measure is the fiscal surplus as a percentage of GDP. The current data include the IMF's World Economic Outlook Update forecasts for 2009 and 2010. As can be seen, fiscal deficits expanded after 1929 but only modestly. Clearly, willingness to run deficits today is considerably greater.

**Figure 6.** Government Budget Surpluses, Now vs Then



Source: Bordo et al. (2001), IMF World Economic Outlook, January 2009.

### Conclusion

To summarise: the world is currently undergoing an economic shock every bit as big as the Great Depression shock of 1929-30. Looking just at the US leads one to overlook how alarming the current situation is even in comparison with 1929-30.

The good news, of course, is that the policy response is very different. The question now is whether that policy response will work. For the answer, stay tuned for our next column.



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