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The Big Recessions of the Past Hundred Years

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Dev Talk OECD-PARIS

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Motivation

- Big recessions are costly. We need to understand them better.
- Big recessions are not easy to predict.
- War, hyperinflation, large external shocks, policy mistakes, populist and protectionist cycles all can cause economic cycles and slumps/contractions.
- Three main global episodes in the last 90 years : great depression (1930s), stagflation (1970s), global financial crises (2008-09).
- Regional crises: Latin America debt crisis of the 1980s, East Asian crisis in the 1990s, post-socialist slumps in the 1990s.
- Is unregulated capitalism inherently unstable?
- How to avoid slumps? How to recover after slumps?

Chapters of the book

- Chapter 1. Introduction
- Chapter 2 . Recessions and Depressions: Theories and Empirics
- Chapter 3. World War I, Hyperinflation in the 1920s and World War II.
- Chapter 4. The Great Depression of the 1930s.
- Chapter 5. Stagflation in the 1970s, Globalization and the Financial Crisis of 2008-09
- Chapter 6. Two Depressions in the Early 21st Century: The Cases of Latvia and Greece
- Chapter 7. Soviet-type of Socialism and the Post-Socialist Transition
- Chapter 8. Economic Crises in Latin America and East Asia.
- Chapter 9. Summary and conclusions.

Intensity and Frequency of Recessions in 1900-2017 (yearly fall in GDP per capita)

Type of decline		1900-2017		1900-1950		1951-2017	
		Obs.	Percent	Obs.	Percent	Obs.	Percent
Recessions	Mild recession (less than 3%)	335	45.0%	115	32.7%	220	56.1%
	Moderate to large recession (between 3% and 10%)	261	35.1%	141	40.1%	120	30.6%
	Severe recession (between 10% and 15%)	61	8.2%	42	11.9%	19	4.8%
Depressions	Depression (between 15% and 30%)	59	7.9%	34	9.7%	25	6.4%
	Mega depression (more than 30%)	28	3.8%	20	5.7%	8	2.0%
Total		744	100.0%	352	100.0%	392	100.0%

What caused big recessions in the long 20th century (1914-2015)?

- Wars (WWI, WWII) and their aftermath.
- Episodes of extreme monetary instability and hyperinflation (Austria, Germany, Hungary, Poland, Russia 1920s; Hungary and Greece, 1940s, Bolivia, Nicaragua, Argentina, Peru, 1980s, Yugoslavia, 1990s, Zimbabwe 2008, Venezuela 2017-19).
- Adverse external shocks, debt cycles and cut-offs in foreign credit ("sudden stops").
- Collapse of fixed exchange rate regimes and currency boards (L.America in the 1980s, East Asia 1997-98, Argentina 2001),
- Premature financial liberalization, credit booms and asset price overvaluation.
- Macroeconomic populism (over-expansionary demand and wage policies that become unsustainable (L. America in the 1970s and Venezuela in the 2010s).
- Political destabilisation, trade embargoes and economic uncertainty.

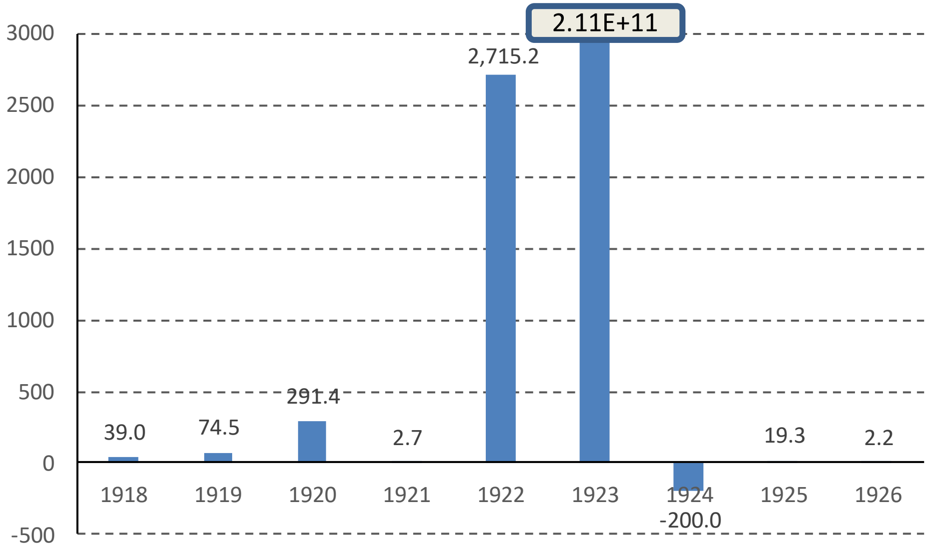
What causes slumps? Theories.

- *Monetarism* → Milton Friedman (central bank's mistakes). The Austrians (Central Banks interfere savings/investment process) .
- *Debt deflation theory* → Irving Fisher (too much debt)
- *Aggregate demand failures* → John Maynard Keynes (too little spending)
- *Credit Crunch* → Ben Bernanke (lack of funding)
- *Financial theories of recession* → Hyman Minsky (inherent financial instability in capitalism)
- *Psychological factors behind crisis* → Charles Kindleberger (watch episodes of euphoria, stress, panics)
- We need theory for mega-depressions: war and hyperinflation

Germany's Hyperinflation Cycle in the 1920s (1918-1926)

Inflation

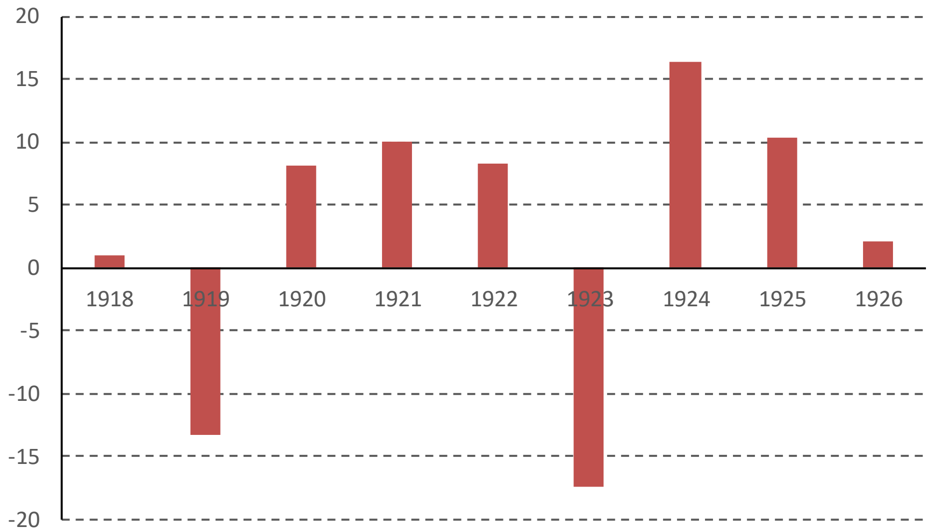
(annual percent change in Consumer Price Index, 1918-1926)



Source: Reinhart & Rogoff (2010)

GDP per capita

(annual percent change, 1918-1926)

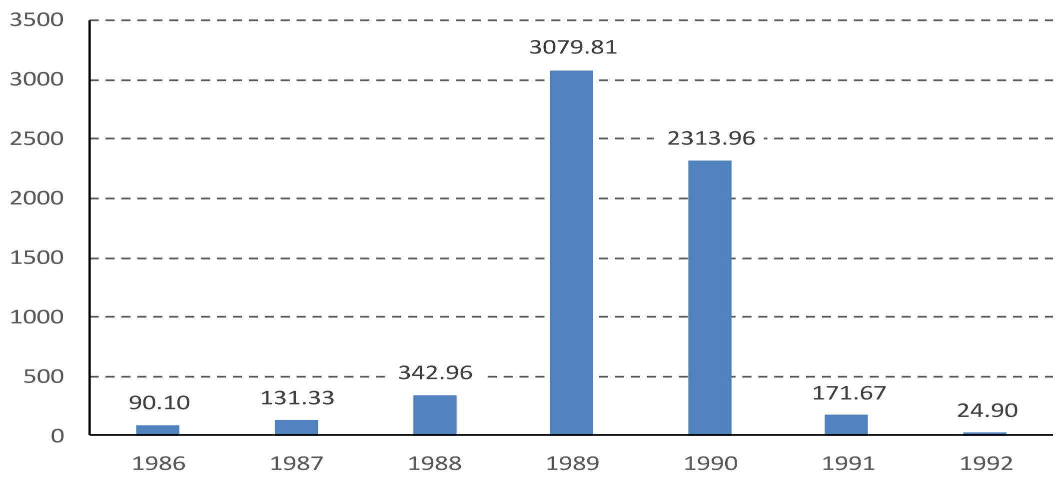


Source: Maddison (2013)

Argentina’s Hyperinflation cycle in the 1980s (1986-1992)

Inflation

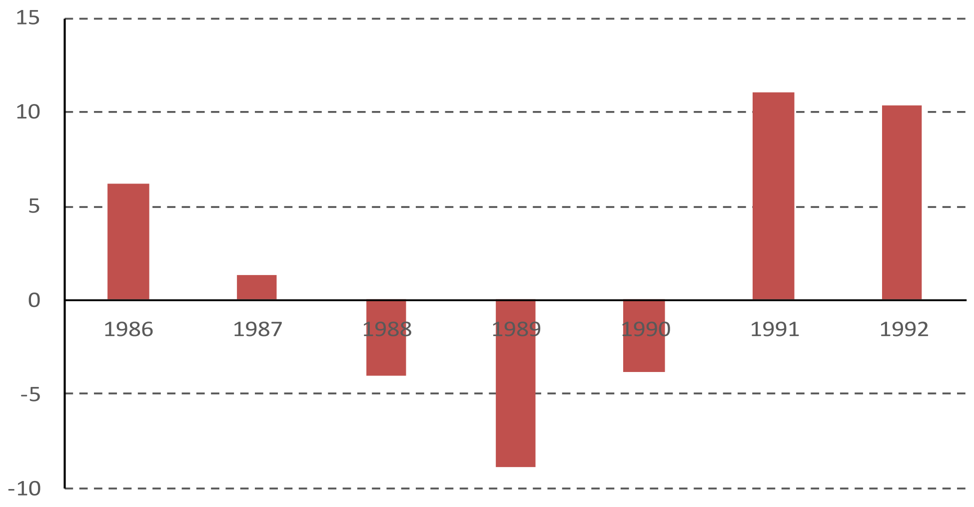
(annual percentage change, CPI. 1986-1992)



Source: INDEC

Output collapse during hyperinflation

(annual percentage change in per capita GDP. 1986-1992)

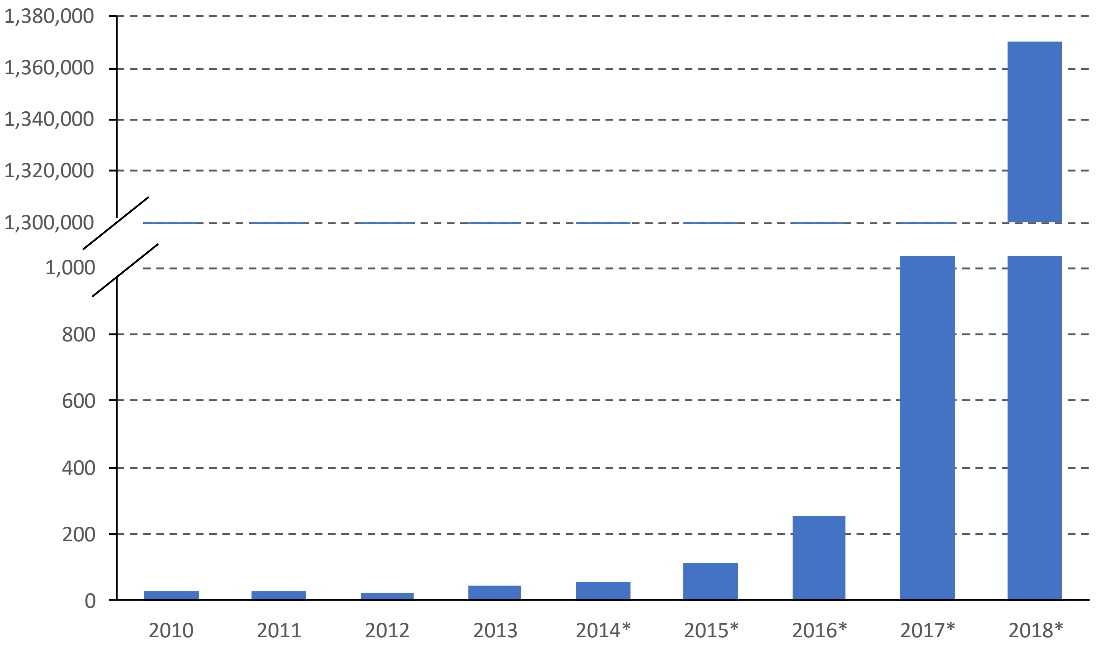


Source: WDI, The World Bank 2018

Venezuela’s Hyperinflation cycle in the late 2010s (2010-2018)

Inflation rates

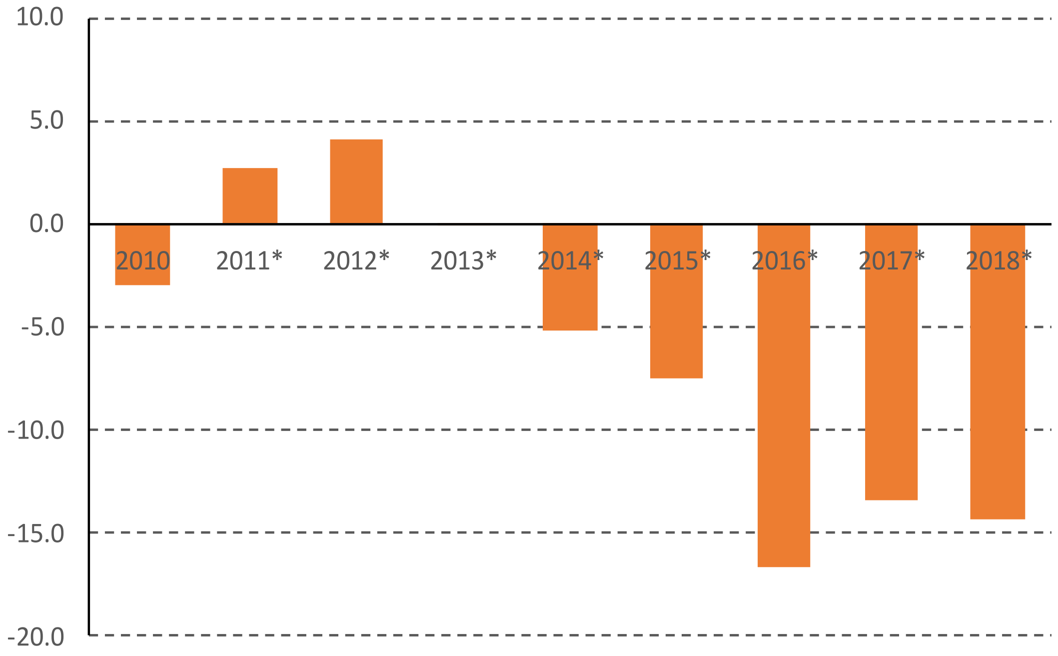
(annual percentage change, CPI. 2010-2018)



Source: INDEC

Output collapse during hyperinflation

(annual percentage change in per capita GDP. 2010-2018)



Source: WDI, The World Bank 2018

The Great Depression of the 1930s.

There is not a single cause of the Great Depression, we can make the following list of factors that did contribute to it:

I. The stock market crash of 1929 in the United States.

II. The decline in terms of trade and capital inflows by exporters of primary products in Latin America, Australia that started in 1928 or before,.

III. Bankruptcies of banks in the early 1930s in America, Austria, Germany.

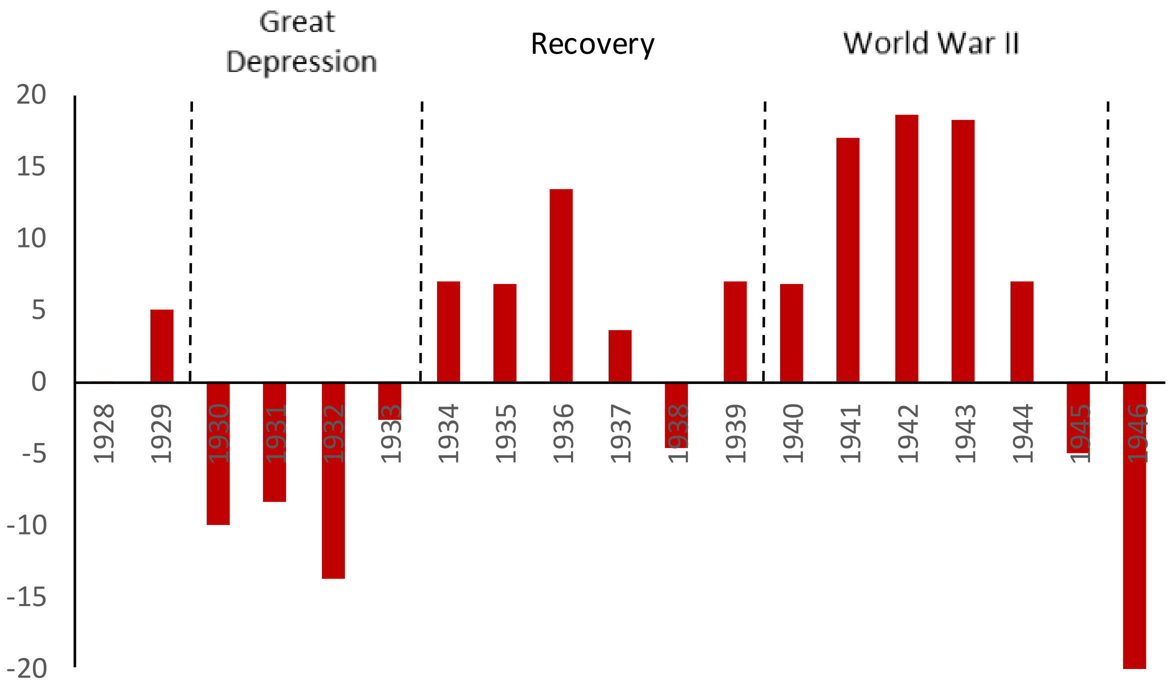
IV. Deflationary policies pursued by central banks in the context of the gold standard,

V. The timing of abandonment of the gold standard (the evidence seems to show that early exit-countries started their recovery sooner).

VI. The fall in domestic prices that increased the real value of debt held by consumers and firms with a negative effect on consumption and investment.

VII. The lack of a decisive fiscal policy stance to face recessions and depressions by governments at that time.

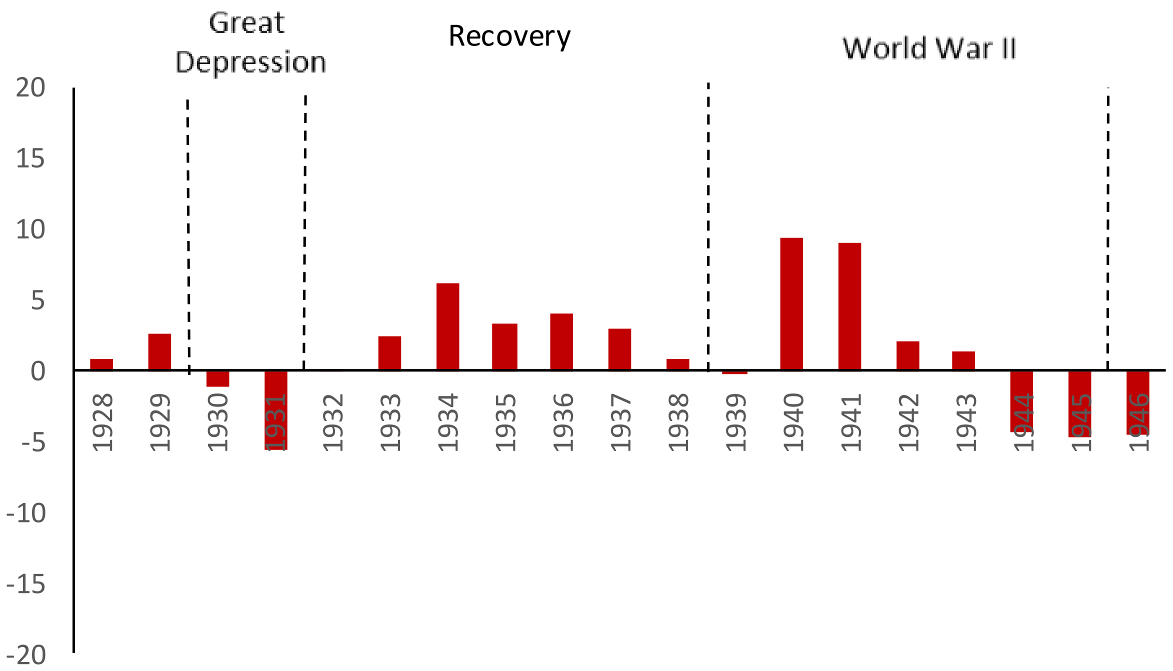
United States: Rate of growth of GDP per capita (percent), 1928-1946



Source: Own elaboration based on The Maddison-Project,

http://www.ggdc.net/maddison/maddison-project/home.htm, 2013 version

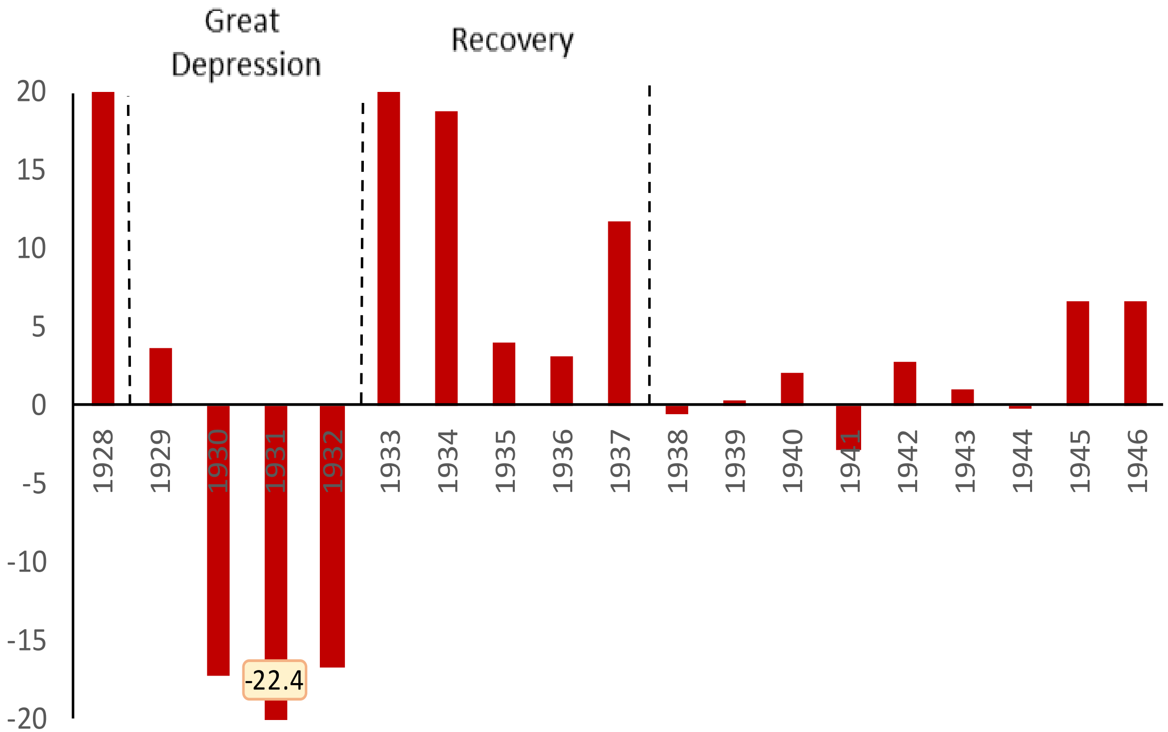
United Kingdom: Rate of growth of GDP per capita (percent), 1928-1946



Source: Own elaboration based on The Maddison-Project,

http://www.ggdc.net/maddison/maddison-project/home.htm, 2013 version

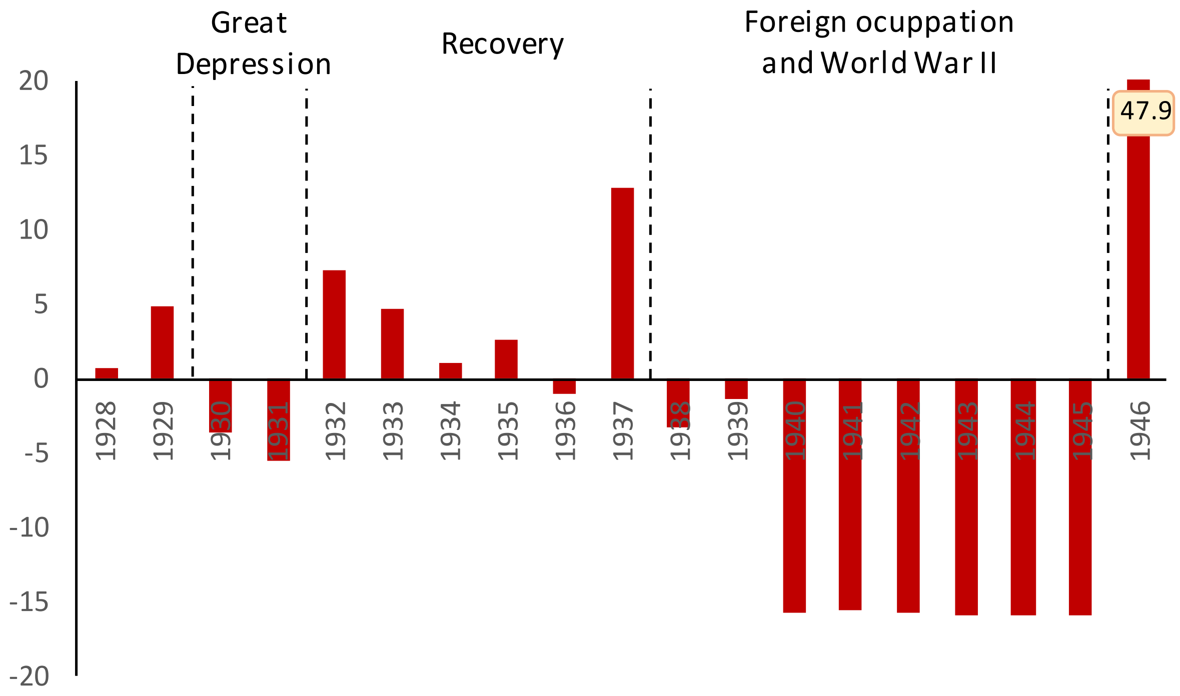
Chile: Rate of growth of GDP per capita (percent), 1928-1946



Source: Own elaboration based on The Maddison-Project,

http://www.ggdc.net/maddison/maddison-project/home.htm, 2013 version

Greece: Rate of growth of GDP per capita (percent), 1928-1946



Source: Own elaboration based on The Maddison-Project,

http://www.ggdc.net/maddison/maddison-project/home.htm, 2013 version

Stagflation in the 1970s

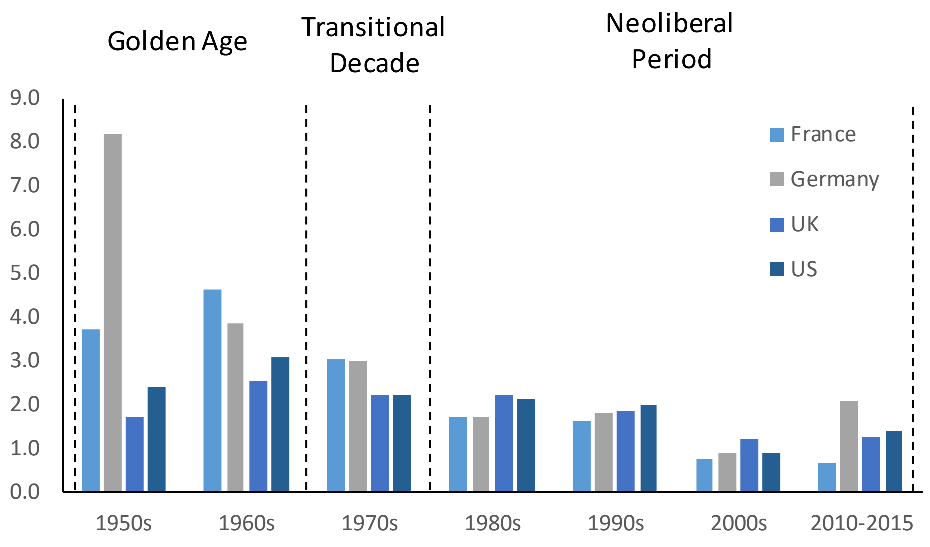
- The emerging economic order, excluded the socialist area that had emerged after WWII, entailed a new international monetary system, the Bretton Woods regime, supporting global political institutions, the United Nations, and a more balanced social contract between capital and labor.
- This new settlement was followed by a period from around 1950 to 1973 of strong growth, absence of global financial crisis and reasonable social peace in advanced capitalist countries. This period was labelled the *golden age of capitalism.*
- The abandonment of the parities of Bretton Woods, heightened labor activism, a slowdown in productivity growth and important shocks to oil prices put an end to this process.
- The 1970s witnessed the simultaneous surge of inflation, slower growth and higher unemployment, known as "stagflation".

Globalization, Financial Deregulation and the Crisis of 2008-09

- The stagflation gives rise to subsequent decades, since the 1980s, of neoliberal globalization accompanied by a greater frequency of financial crises and recessionary cycles than in the golden age.
- In the late 1990s/early 2000s US growth fell following the bursting of the dot.com bubble in the high-tech sector.
- A main crisis of neoliberal globalization took place in 2008-09 and was originated by the sub-prime crisis in the US spreading to Europe. This was followed by a period of sluggish growth in advanced (center) economies and serious contraction of economic activity in the European periphery.
- Peripherial countries had significant levels of sovereign and private debt that rendered them particularly vulnerable to changes in confidence levels in international capital markets, making them prone to “sudden stops” that often have devastating effects on real economic activity
- Increased instability and volatility had become a more structural feature of neoliberal capitalism.

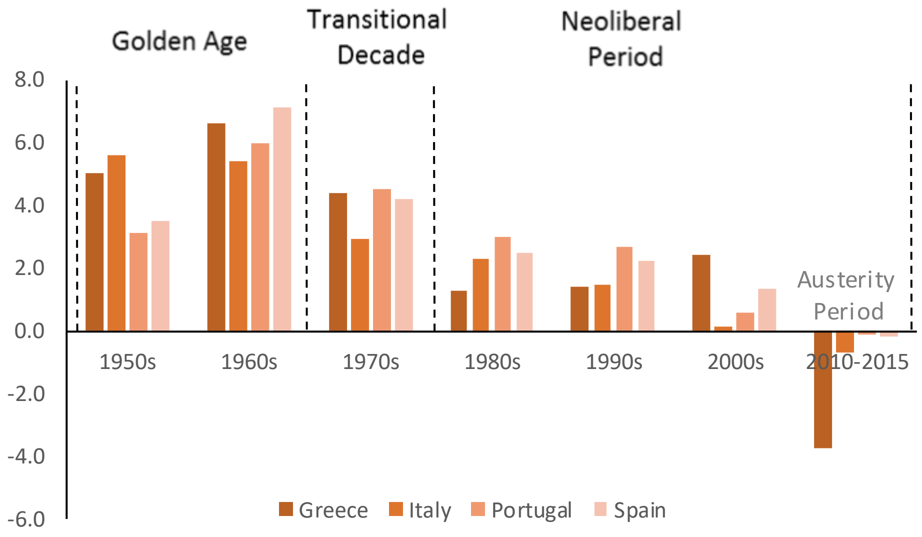
The Phases of 1950-2015: Core Economies and European Periphery (percent change in GDP per capita)

- **Core Economies: GDP per capita, average rate of change (%) by decade, 1950-2015**



Source: Data for 1950-1989 period from The Maddison-Project, 2013 version; and for 1990-2015 period from World Development Indicators, The World Bank 2017

- **European Periphery: GDP per capita, average rate of change (%) by decade, 1950-2015**



Source: Data for 1950-1989 period from Kornai (2006), and for 1990-2015 period from World Development Indicators, The World Bank 2017

Two Depressions in the Early 21st Century: Latvia and Greece

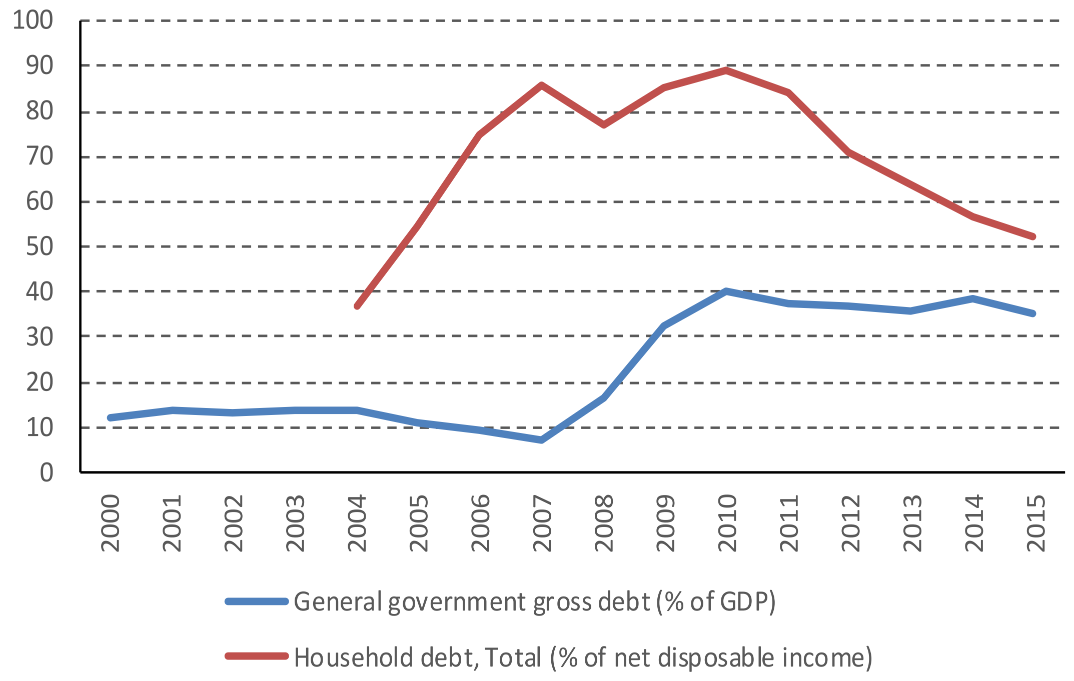
- We can identify at least two depressions in the European periphery following the global financial crisis of 2008-09: Latvia and Greece. Both episodes were surrounded by the direct intervention in the content of internal economic policies by the International Monetary Fund and European governments.
- The intensity of the depression was severe in the two countries: in Latvia GDP declined by 22 percent in 2008-10 and in Greece GDP declined by 29 percent between 2008 and 2013.
- Both episodes can qualify as *depressions* if we use at least one of the two criteria: (i) a successive fall in GDP that lasts at least three years and (ii) a drop of output above 10 percent.

Latvia and Greece: Cont.

- The depressions of Latvia and Greece were closely managed by the IMF and the troika and were preceded by a domestic boom directly associated with their modernization project of joining the European Union.
- In the pre-crisis period Greece receive abundant foreign credit to finance its fiscal deficits and stimulated consumption and investment. Latvia also received massive capital inflows in the run-up to the crisis.
- Austerity policies in both nations were very costly, leading to severe cuts in investment, output and rising unemployment. Public debt ratios kept growing as well as household debt.
- In the two countries the economic crises led also to massive emigration of part of the local population to escape from domestic economic hardship.

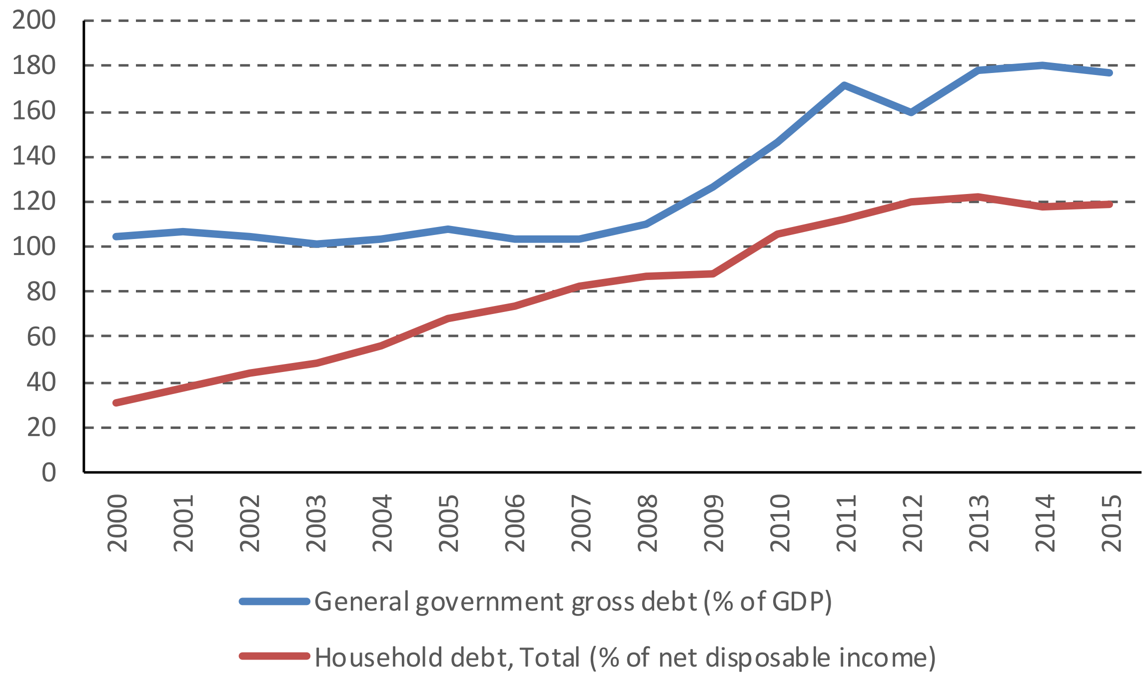
Debt and Austerity

LATVIA



Source: Data for Central government gross debt from International Monetary Fund, World Economic Outlook Database, October 2016, and for Household debt from OECD (2017), Household debt (indicator). doi: 10.1787/f03b6469-en (Accessed on 7 May 2017)

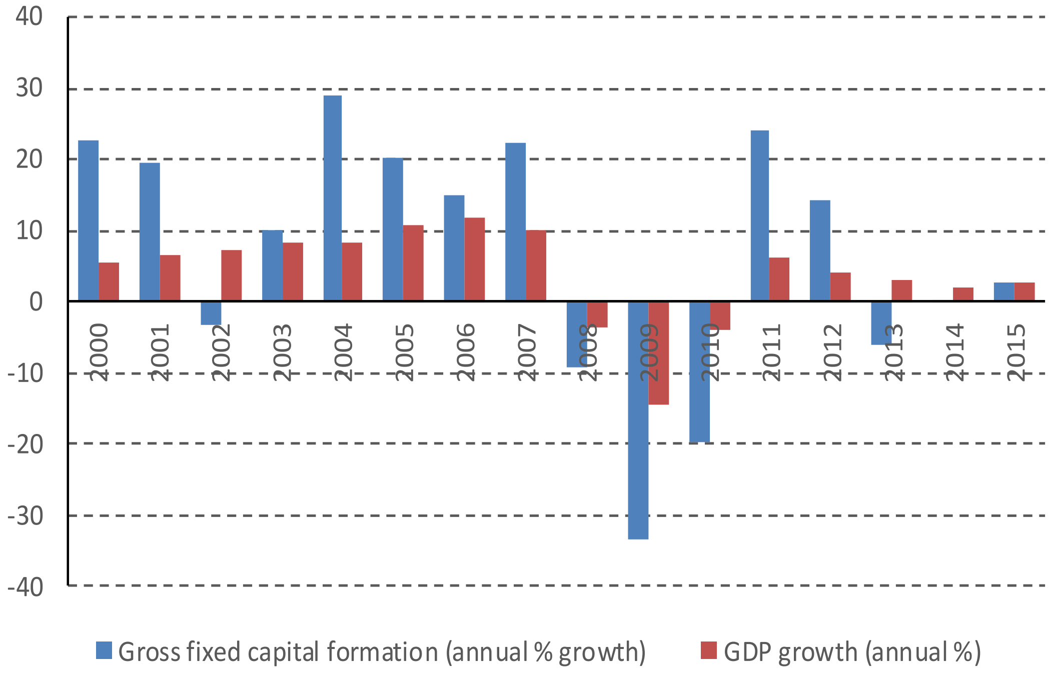
GREECE



Source: Data for Central government gross debt from International Monetary Fund, World Economic Outlook Database, October 2016, and for Household debt from OECD (2017), Household debt (indicator). doi: 10.1787/f03b6469-en (Accessed on 7 May 2017)

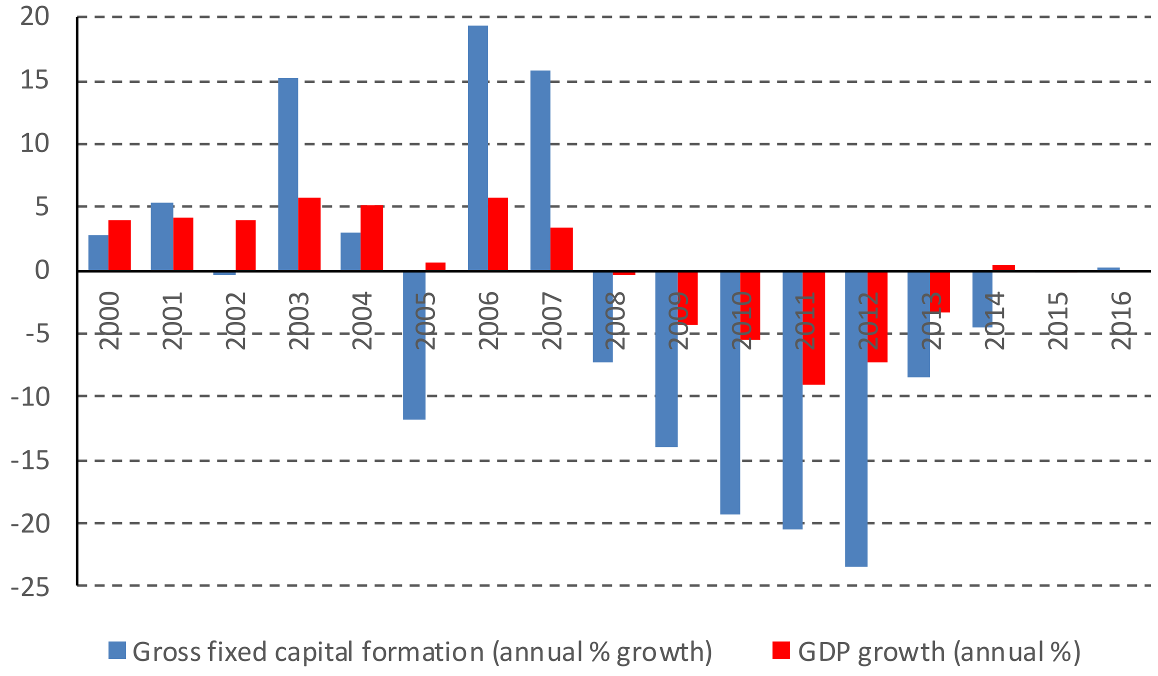
Crash and Painful Recovery

Latvia: GDP growth and Investment Growth (percent change, 2000-2015)



Source: World Development Indicators, The World Bank 2017

Greece: GDP growth and Investment Growth (percent change, 2000-2015)



Source: World Development Indicators, The World Bank 2017

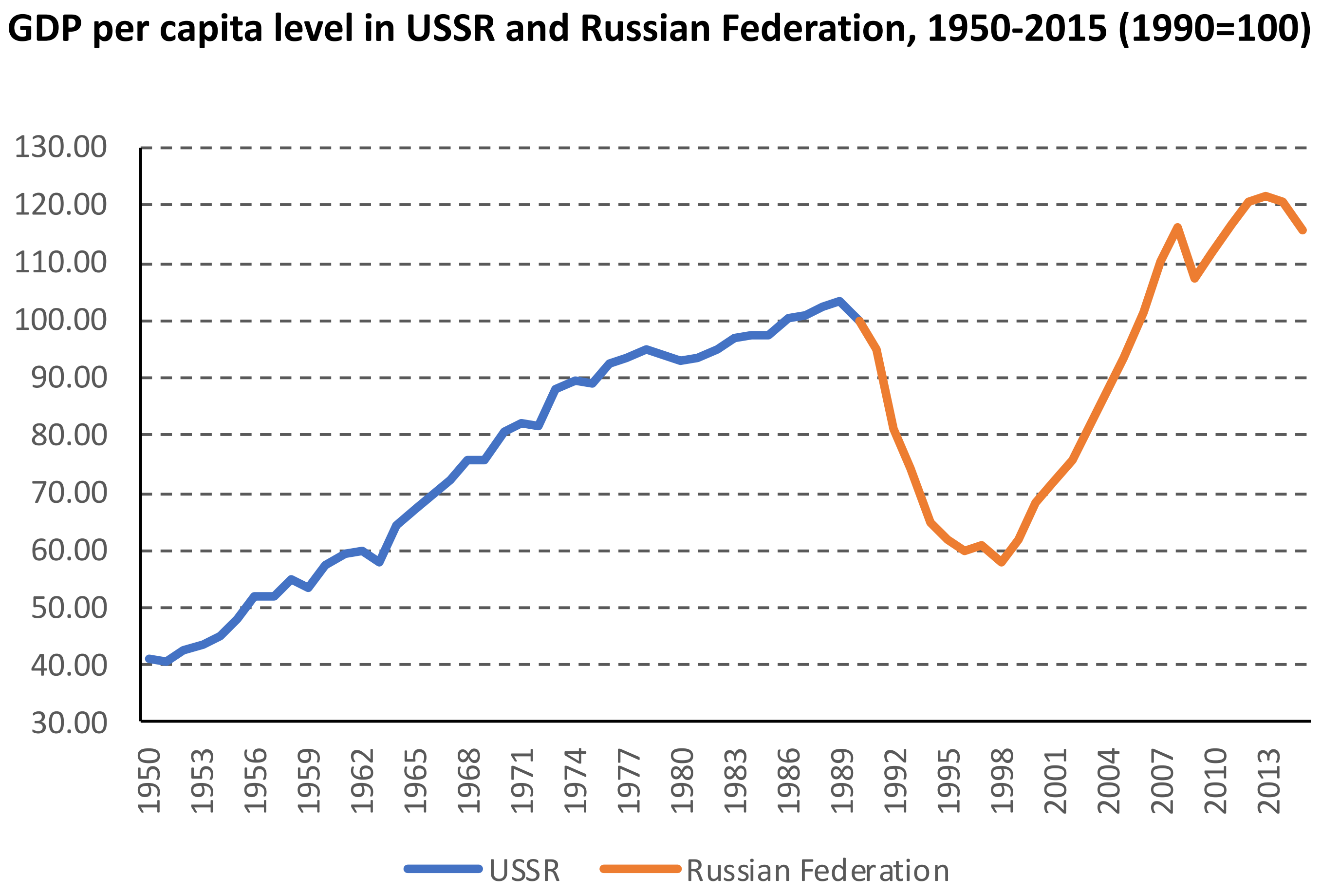
Output Collapse in the Initial Years of Post-Socialist Transition

- The size of the contraction of GDP, investment and real wages in the former socialist countries of Central-Eastern Europe (CEE) in the initial phase of transition (early to mid 1990s) after the demise of the socialist regimes was even larger than in the Great Depression and the Subprime Crisis.
- The return to capitalism in this area of the world has been affected by two mayor recessionary and stagnation cycles:
  - (i) the deep contraction in GDP and investment in the early 1990s
  - (ii) the recessive economic consequences of the financial crisis of 2008-09 and its aftermath.

Output under Socialism and the Post-Socialist Transition

- Three periods can be identified in the socialist republics after the WWII:
  I. A cycle of acceleration in the rates of economic growth per capita in the 1950s and 1960s guided by intense inversion and capital formation.
  II. A slowdown in the 1970s
  III. Stagnation/contraction of the 1980s before the ultimate demise of the centrally planned regimes.
- Several centrally-planned economies borrowed in convertible currencies in western capital markets in the 1970s and 1980s, increasing substantially their levels of external debt.

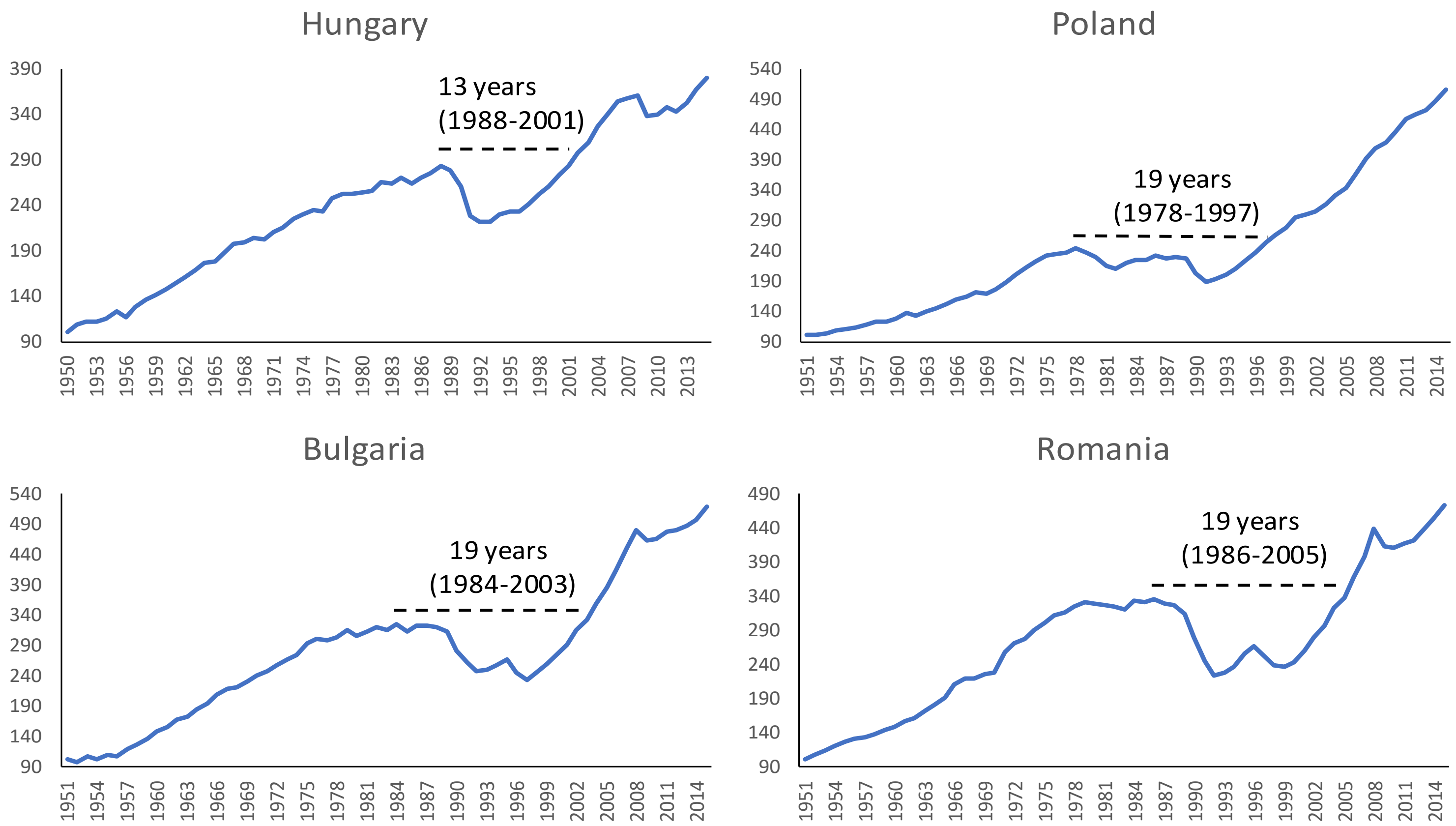
USSR and Russia



Source: Data for 1951-1990 period from The Maddison-Project, http://www.ggdc.net/maddison/maddison-project/home.htm, 2013 version; and for 1991-2015 period from World Development Indicators, The World Bank 2017

Hungary , Poland , Bulgaria and Rumania

GDP per capita, 1950-2015 (1950=100)



Source: Data for 1950-1999 period from The Maddison-Project, http://www.ggdc.net/maddison/maddison-project/home.htm, 2013 version; and for 2000-2015 period from World Development Indicators, The World Bank 2017

Economic Crises in Latin America and East Asia

- Latin America is a net exporter of commodities, inequality is high and distributive conflicts make policy consensus often difficult to attain.
- In Chile and Argentina, in the early 1970s left-wing governments implemented over-expansive fiscal, credit and wage policies. This led to economic and political destabilization, followed by military coups and democracy collapse.
- Right-wing military regimes embraced free-market therapy and shock treatment with adverse output consequences. The 1980s was the "lost decade" in Latin America as a consequence of the debt crisis, high inflation and severe output contraction.
- There has been episodes of hyperinflation in Bolivia (1985) Nicaragua (1986-91), Peru(1988-90), Argentina (1999-90) and more recently Venezuela (2017-).
- Venezuela, enjoyed a windfall of high oil prices in the 1970s, maintained democracy at a time other Latin American countries turned to authoritarian regimes.

Latin America and East Asia

- The economies of East Asia in the period 1970-2018 were affected in different ways by the cycles of the international economy, domestic economic policies and other factors.
- The economies of East Asia in the period 1970-2018 had a much lower frequency of episodes of economic contraction and more rapid recoveries than in Latin America.
- China and Vietnam had their recessions in the 1970s but avoided output contractions in subsequent decades.
- The worst meltdown was during the financial crisis of 1997-99 that hit hard Indonesia, Korea, Thailand, Malaysia and the Philippines.
- The global financial crisis of 2008-09 led to output declines in the Philippines (small), Thailand, Malaysia, Hong Kong and Singapore.

Synthesis and Interpretation

- The analysis of world economic crisis during the long 20th century, have shown that they can take place because of several factors:
    I. Armed conflicts such as World War I and II
    II. Extreme monetary instability and hyperinflation
    III. Collapses in exchange rate regimes
    IV. Sharp systemic change such as the end of central planning and the transition to capitalism in the former USSR, Central and Eastern Europe in the 1990s,
    V. Macroeconomic crises following over-expansionary fiscal/credit and wage policies,
    VI. Adverse terms of trade shocks,
    VII. Sudden cuts in capital inflows and other factors,
    VIII. Premature financial liberalization.