Why?

More than 10 years after the fall, we remain perplexed by the failure to answer basic questions such as "why was the crash so deep" and "why we are still haunted by it".

Recently, **Bernanke** has tried to answer the first question, while **Jason Furman/Martin Sandbu** take a stab at the second.

Now, Brad DeLong "goes for broke", asking, "**Was the Great Recession more Damaging than the Great Depression?**"

> Your parents' – more likely your grandparents' – Great Depression opened with the then-biggest-ever stock market crash, continued with the largest-ever sustained decline in GDP, and ended with a near-decade of subnormal production and employment. Yet 11 years after the 1929 crash, national income per worker was 10 percent above its 1929 level. The next year, 12 years after, it was 28 percent above its 1929 level. The economy had fully recovered. And then came the boom of World War II, followed by the "thirty glorious years" of post-World War II prosperity.
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> The Great Depression was a nightmare. **But the economy then woke up – and it was not haunted thereafter**.
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> Our "Great Recession" opened in 2007 with what appeared to be a containable financial crisis. The economy subsequently danced on a knife-edge of instability for a year. Then came the crash – in stock market values, employment and GDP. The experience of the Great Depression, however, gave policymakers the knowledge and running room to keep our depression-in-the-making an order of magnitude less severe than the Great Depression.
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> That's all true. But it's not the whole story. **The Great Recession has cast a very large shadow on America's future prosperity. We are still haunted by it**. Indeed, this is the year, the eleventh after the start of the crisis, when national income per worker relative to its pre-crisis benchmark **begins to lose the race to recovery relative to the Great Depression**.

It´s very depressing, or should be. Policymakers, however, try to "hide" that feeling behind "optimistic" assessments. An example is given by Fed Board Member Randy Quarles in a recent **presentation** to The Economic Club of New York:

Today, I'd like to offer my take on the economic outlook, which is **optimistic**, and explain how I view my optimism as consistent with the continued gradual pace of policy tightening that many Committee participants have projected. In particular, I'll explain how my views on potential growth help shape my outlook, both for the economy and for the appropriate path of monetary policy.

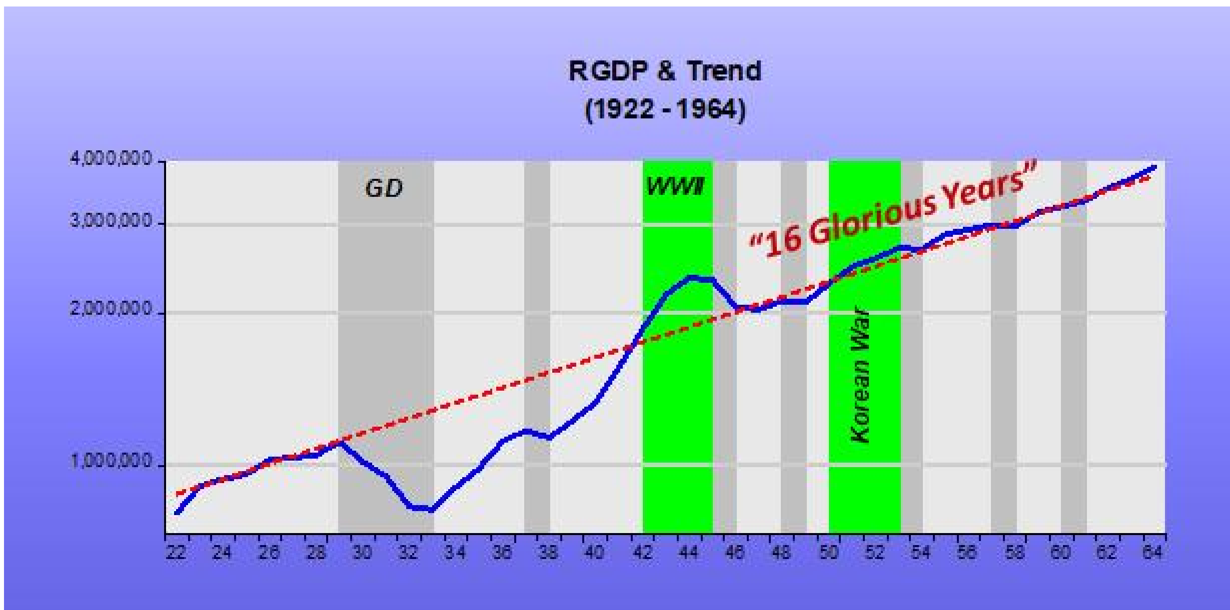
Relatedly, I'll discuss the uncertainties that arise when a central element of the outlook – in this case, the potential capacity of the economy – is unknown and largely unobservable. Such uncertainty can complicate policymaking in even what **appears to be a very healthy economy**, providing a further argument for gradualism.

So, where are we now? In previous remarks on the economic outlook that I delivered at the National Association for Business Economics in February, I characterized the U.S. economy as being in a **good spot** and asked if the economy had reached a positive turning point following an extended period of post-crisis slow growth. I argued that while it might be too soon to call a turning point, there was a definite possibility of an upside surprise.

According to DeLong, "The Great Depression was a nightmare. **But the economy then woke up – and it was not haunted thereafter**."

Why was that? It reflects the fact that for more than 100 years, the American economy evolved along a stable trend. That means, in statistical parlance, that US RGDP is "trend stationary". In other words, shocks do not have permanent effects.

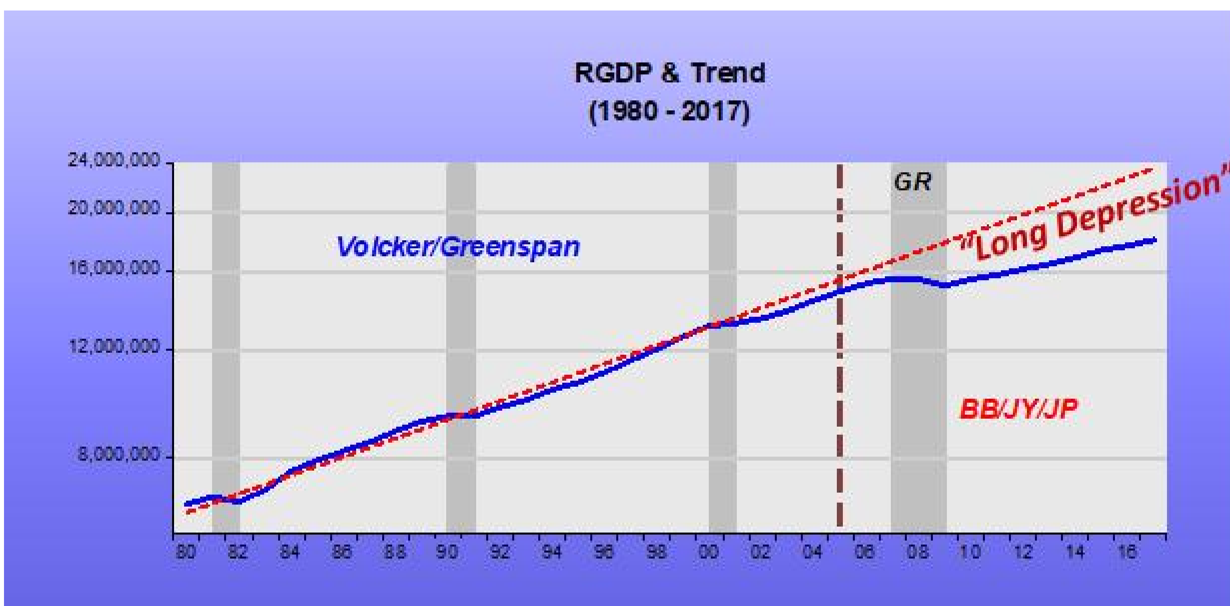
The chart below illustrates, with the trend estimated from 1900 to 2000.



The Great Depression shows up as a massive deviation from trend, with the recovery, which began in 1933, interrupted by the recession of 1937/38. In any case, by the time the US entered WWII, output was back "on track".

Instead of "30 glorious years", it was more like 16, with the following years characterized by the "Great Inflation".

The picture is very different today.



It appears monetary policy was just sufficient to "swap" a "great depression" for a "long depression"! So, it´s hard to accept Quarles characterization of "…what **appears to be a very healthy economy".**

In trying to understand the present predicament, DeLong asks:

Hysteresis, Incompetence or Both?

> Why has our Great Recession cast such a pall on our future prosperity, while the Great Depression did not? We do not really know for sure — but there's plenty to mull.
>
> Economists talk about "hysteresis" — the idea that what happens in the short run has a substantial and permanent impact on the long run. And, indeed, in the context of recessions, there are powerful channels that generate such hysteresis.
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> - Workers without jobs for years lose their skills, their morale and their attachment to the social networks that help them find jobs.
> - Investments not made during a recession cannot all be made up thereafter. Investments must come in sequence, and so investments not made in the past, even if investors make up the ground, still delay productivity growth.
> - Experiments in new sorts of business organization and in unproven technology that are not undertaken due to the unfavorable conditions of a recession rob the economy of capabilities it would otherwise have years later.
>
> There is little question that some of the damage done during economic downturns can't be washed away by growth. **The problem is that hysteresis ought to apply to the Great Depression era as much as to our own.** Was the 1920s economy of mass production and electrification so much more dynamic than ours? You can make that argument, but barely; at least until the past decade, the productivity growth trend in America had been a steady 2 percent annually since 1870, with no big speedups or slowdowns. But, then, **there is that last decade to ponder**.

They don´t seem, however, to be doing any "pondering". Quarles, for example, concludes:

> Given that the economy has performed fundamentally as I expected at the outset of this year, in my view the right

strategy is to **maintain the gradual course that I have thought appropriate for some time now**.

Put another way, while I think that there is enough – while I believe that there is enough reason to think that the productive capacity of our economy might be increasing so that we should not feel compelled to accelerate our pace, **I also believe that there is enough doubt about current inflation as an infallibly reliable measure of current resource constraints that the continued gradual removal of accommodation is appropriate.** Like pilots back in the days of radio beacons, we should not chase the needles. Thank you very much for that opportunity.