

Free market economy assignment



**ASSIGN
BUSTER**

http://www.fact-archive.com/encyclopedia/Planned_economy Taken as a whole, a centrally planned economy would attempt to substitute a number of firms with a single firm for an entire economy. As such, the stability of a planned economy has implications with the Theory of the firm. After all, most corporations are essentially 'centrally planned economies', aside from some token intra-corporate pricing (not to mention that the politics in some corporations resemble that of the Soviet Politburo). That is, corporations are essentially miniature centrally planned economies and seem to do just fine in a free market.

As pointed out by Kenneth Arrow and others, the existence of firms in free markets shows that there is a need for firms in free markets; opponents of planned economies would simply argue that there is no need for a sole firm for the entire economy. [pic] [pic] The Great Depression was a worldwide economic downturn starting in most places in 1929 and ending at different times in the 1930s or early 1940s for different countries. [1] It was the largest and most important economic depression in modern history, and is used in the 21st century as an example of how far the world's economy can fall. 2] The Great Depression originated in the United States; historians most often use as a starting date the stock market crash on October 29, 1929, known as Black Tuesday. The end of the depression in the U. S is associated with the onset of the war economy of World War II, beginning around 1939. The depression had devastating effects in virtually every country, rich or poor. International trade plunged by half to two-thirds, as did personal income, tax revenue, prices and profits. Cities all around the world were hit hard, especially those dependent on heavy industry.

Construction was virtually halted in many countries. Farming and rural areas suffered as crop prices fell by roughly 60 percent. [4][5][6] Facing plummeting demand with few alternate sources of jobs, areas dependent on primary sector industries such as farming, mining and logging suffered the most. [7] However, even shortly after the Wall Street Crash of 1929, optimism persisted; John D. Rockefeller said that “ These are days when many are discouraged. In the 93 years of my life, depressions have come and gone. Prosperity has always returned and will again. [8] The Great Depression ended at different times in different countries; for subsequent history see Home front during World War II. The majority of countries set up relief programs, and most underwent some sort of political upheaval, pushing them to the left or right. In some states, the desperate citizens turned toward nationalist demagogues??? the most infamous being Adolf Hitler??? setting the stage for World War II in he deflation spiral [pic] [pic] US Farm Prices, (1928-35). The Great Depression was triggered by a sudden, total collapse in the stock market.

The stock market turned upward in early 1930, returning to early 1929 levels by April, though still almost 30 percent below the peak of September 1929. [9] Together, government and business actually spent more in the first half of 1930 than in the corresponding period of the previous year. But consumers, many of whom had suffered severe losses in the stock market the previous year, cut back their expenditures by ten percent, and a severe drought ravaged the agricultural heartland of the USA beginning in the summer of 1930.



In early 1930, credit was ample and available at low rates, but people were reluctant to add new debt by borrowing. By May 1930, auto sales had declined to below the levels of 1928. Prices in general began to decline, but wages held steady in 1930, then began to drop in 1931. Conditions were worse in farming areas, where commodity prices plunged, and in mining and logging areas, where unemployment was high and there were few other jobs. The decline in the US economy was the factor that pulled down most other countries at first, and then internal weaknesses or strengths in each country made conditions worse or better.

Frantic attempts to shore up the economies of individual nations through protectionist policies, such as the 1930 U. S. Smoot-Hawley Tariff Act and retaliatory tariffs in other countries, exacerbated the collapse in global trade. By late in 1930, a steady decline set in which reached bottom by March 1933. There were multiple causes for the first downturn in 1929, including the structural weaknesses and specific events that turned it into a major depression and the way in which the downturn spread from country to country. In relation to the 1929 downturn, historians emphasize structural factors like massive bank failures and the stock market crash, while economists (such as Peter Temin and Barry Eichengreen) point to Britain's decision to return to the Gold Standard at pre-World War I parities (US\$4.86:1). Recession cycles are thought to be a normal part of living in a world of inexact balances between supply and demand. What turns a usually mild and short recession or "ordinary" business cycle into a great depression is a subject of debate and concern.

Scholars have not agreed on the exact causes and their relative importance. The search for causes is closely connected to the question of how to avoid a future depression, and so the political and policy viewpoints of scholars are mixed into the analysis of historic events eight decades ago. The even larger question is whether it was largely a failure on the part of free markets or largely a failure on the part of governments to curtail widespread bank failures, the resulting panics, and reduction in the money supply.

Those who believe in a large role for the state in the economy believe it was mostly a failure of the free markets and those who believe in free markets believe it was mostly a failure of government that compounded the problem.

Current theories may be broadly classified into three main points of view.

First, there is orthodox classical economics: monetarist, Austrian Economics and neoclassical economic theory, all of which focus on the macroeconomic effects of money supply and the supply of gold which backed many currencies before the Great Depression, including production and consumption.   USA GDP annual pattern and long-term trend, 1920-40, in billions of dollars at constant prices. [10] Second, there are structural theories, most importantly Keynesian, but also including those of institutional economics, that point to under consumption and over investment (economic bubble), malfeasance by bankers and industrialists, or incompetence by government officials. The only consensus viewpoint is that there was a large-scale lack of confidence.

Unfortunately, once panic and deflation set in, many people believed they could make more money by keeping clear of the markets as prices got lower and lower and a given amount of money bought ever more goods. Third,

<https://assignbuster.com/free-market-economy-assignment/>

there is the Marxist critique of political economy. This emphasizes the tendency of capitalism to create unbalanced accumulations of wealth, leading to over accumulations of capital and a repeating cycle of devaluations through economic crises. Marx saw recession and depression as unavoidable under free-market capitalism as there are no restrictions on accumulations of capital other than the market itself.

Debt deflation [pic] [pic] Crowd at New York's American Union Bank during a bank run early in the Great Depression. Irving Fisher argued that the predominant factor leading to the Great Depression was over indebtedness and deflation. Fisher tied loose credit to over-indebtedness, which fueled speculation and asset bubbles. [11] He then outlined 9 factors interacting with one another under conditions of debt and deflation to create the mechanics of boom to bust. The chain of events proceeded as follows: 1. Debt liquidation and distress selling 2.

Contraction of the money supply as bank loans are paid off 3. A fall in the level of asset prices 4. A still greater fall in the net worth's of business, precipitating bankruptcies 5. A fall in profits 6. A reduction in output, in trade and in employment. 7. Pessimism and loss of confidence 8. Hoarding of money 9. A fall in nominal interest rates and a rise in deflation adjusted interest rates. [11] [pic] [pic] Crowd gathering on Wall Street after the 1929 crash. During the Crash of 1929 preceding the Great Depression, margin requirements were only 10%.

Brokerage firms, in other words, would lend \$9 for every \$1 an investor had deposited. When the market fell, brokers called in these loans, which could

not be paid back. Banks began to fail as debtors defaulted on debt and depositors attempted to withdraw their deposits en masse, triggering multiple bank runs. Government guarantees and Federal Reserve banking regulations to prevent such panics were ineffective or not used. Bank failures led to the loss of billions of dollars in assets. [12] Outstanding debts became heavier, because prices and incomes fell by 20??? 50% but the debts remained at the same dollar amount.

After the panic of 1929, and during the first 10 months of 1930, 744 US banks failed. (In all, 9, 000 banks failed during the 1930s). By April 1933, around \$7 billion in deposits had been frozen in failed banks or those left unlicensed after the March Bank Holiday. [13] Bank failures snowballed as desperate bankers called in loans which the borrowers did not have time or money to repay. With future profits looking poor, capital investment and construction slowed or completely ceased. In the face of bad loans and worsening future prospects, the surviving banks became even more conservative in their lending. [12] Banks built up their capital reserves and made fewer loans, which intensified deflationary pressures. A vicious cycle developed and the downward spiral accelerated. The liquidation of debt could not keep up with the fall of prices which it caused. The mass effect of the stampede to liquidate increased the value of each dollar owed, relative to the value of declining asset holdings. The very effort of individuals to lessen their burden of debt effectively increased it. Paradoxically, the more the debtors paid, the more they owed. [11] This self-aggravating process turned a 1930 recession into a 1933 great depression. Macroeconomists including Ben Bernanke, the current chairman of the U. S. Federal Reserve

Bank, have revived the debt-deflation view of the Great Depression originated by Fisher. [14][15] Trade decline and the U. S. Smoot-Hawley Tariff Act Main article: Smoot-Hawley Tariff Act Many economists have argued that the sharp decline in international trade after 1930 helped to worsen the depression, especially for countries significantly dependent on foreign trade.

Most historians and economists partly blame the American Smoot-Hawley Tariff Act (enacted June 17, 1930) for worsening the depression by seriously reducing international trade and causing retaliatory tariffs in other countries. Foreign trade was a small part of overall economic activity in the United States and was concentrated in a few businesses like farming; it was a much larger factor in many other countries. [16] The average ad valorem rate of duties on dutiable imports for 1921-1925 was 25.9% but under the new tariff it jumped to 50% in 1931-1935.

In dollar terms, American exports declined from about \$5.2 billion in 1929 to \$1.7 billion in 1933; but prices also fell, so the physical volume of exports only fell by half. Hardest hit were farm commodities such as wheat, cotton, tobacco, and lumber. According to this theory, the collapse of farm exports caused many American farmers to default on their loans, leading to the bank runs on small rural banks that characterized the early years of the Great Depression. U. S. Federal Reserve and money supply

Monetarists, including Milton Friedman and current Federal Reserve System chairman Ben Bernanke, argue that the Great Depression was caused by monetary contraction, the consequence of poor policymaking by the

American Federal Reserve System and continuous crisis in the banking system. [17][18] In this view, the Federal Reserve, by not acting, allowed the money supply as measured by the M2 to shrink by one-third from 1929 to 1933. Friedman argued[19] that the downward turn in the economy, starting with the stock market crash, would have been just another recession.

The problem was that some large, public bank failures, particularly that of the New York Bank of the United States, produced panic and widespread runs on local banks, and that the Federal Reserve sat idly by while banks fell. He claimed that, if the Fed had provided emergency lending to these key banks, or simply bought government bonds on the open market to provide liquidity and increase the quantity of money after the key banks fell, all the rest of the banks would not have fallen after the large ones did, and the money supply would not have fallen as far and as fast as it did. 20] With significantly less money to go around, businessmen could not get new loans and could not even get their old loans renewed, forcing many to stop investing. This interpretation blames the Federal Reserve for inaction, especially the New York branch. [21] One reason why the Federal Reserve did not act to limit the decline of the money supply was regulation. At that time the amount of credit the Federal Reserve could issue was limited by laws which required partial gold backing of that credit. By the late 1920s the Federal Reserve had almost hit the limit of allowable credit that could be backed by the gold in its possession.

This credit was in the form of Federal Reserve demand notes. Since a “promise of gold” is not as good as “gold in the hand”, during the bank panics a portion of those demand notes were redeemed for Federal Reserve

gold. Since the Federal Reserve had hit its limit on allowable credit, any reduction in gold in its vaults had to be accompanied by a greater reduction in credit. On April 5 1933 President Roosevelt signed Executive Order 6102 making the private ownership of gold illegal, reducing the pressure on Federal Reserve gold. [22] Austrian School explanations Another explanation comes from the Austrian School of economics.

Theorists of the “ Austrian School” who wrote about the Depression include Austrian economist Friedrich Hayek and American economist Murray Rothbard, who wrote America’s Great Depression (1963). In their view, the key cause of the Depression was the expansion of the money supply in the 1920s that led to an unsustainable credit-driven boom. In their view, the Federal Reserve, which was created in 1913, shoulders much of the blame. One reason for the monetary inflation was to help Great Britain, which, in the 1920s, was struggling with its plans to return to the gold standard at pre-war (World War I) parity.

Returning to the gold standard at this rate meant that the British economy was facing deflationary pressure. [23] According to Rothbard, the lack of price flexibility in Britain meant that unemployment shot up, and the American government was asked to help. The United States was receiving a net inflow of gold, and inflated further in order to help Britain return to the gold standard. Montagu Norman, head of the Bank of England, had an especially good relationship with Benjamin Strong, the de facto head of the Federal Reserve.

Norman pressured the heads of the central banks of France and Germany to inflate as well, but unlike Strong, they refused. [23] Rothbard says American inflation was meant to allow Britain to inflate as well, because under the gold standard, Britain could not inflate on its own. In the Austrian view it was this inflation of the money supply that led to an unsustainable boom in both asset prices (stocks and bonds) and capital goods. By the time the Fed belatedly tightened in 1928, it was far too late and, in the Austrian view, a depression was inevitable.

The artificial interference in the economy was a disaster prior to the Depression, and government efforts to prop up the economy after the crash of 1929 only made things worse. According to Rothbard, government intervention delayed the market's adjustment and made the road to complete recovery more difficult. [24] Furthermore, Rothbard criticizes Milton Friedman's assertion that the central bank failed to inflate the supply of money. Rothbard asserts that the Federal Reserve bought \$1.1 billion of government securities from February to July 1932, raising its total holding to \$1.1 billion. Total bank reserves rose by only \$212 million, but Rothbard argues that this was because the American populace lost faith in the banking system and began hoarding more cash, a factor quite beyond the control of the Central Bank. The potential for a run on the banks caused local bankers to be more conservative in lending out their reserves, and this, Rothbard argues, was the cause of the Federal Reserve's inability to inflate. [25] [pic] [pic] Power farming displaces tenants from the land in the western dry cotton area. Childress County, Texas, 1938. Business Franklin D.

Roosevelt, elected in 1932 and inaugurated March 4, 1933, primarily blamed the excesses of big business for causing an unstable bubble-like economy. Democrats believed the problem was that business had too much money, and the New Deal was intended as a remedy, by empowering labor unions and farmers and by raising taxes on corporate profits. Regulation of the economy was a favorite remedy. Some New Deal regulation (the NRA and AAA) was declared unconstitutional by the U. S. Supreme Court. Most New Deal regulations were abolished or scaled back in the 1970s and 1980s in a bipartisan wave of deregulation. 26] However the Securities and Exchange Commission and Social Security won widespread support. Lack of government deficit spending British economist John Maynard Keynes argued in *General Theory of Employment Interest and Money* that lower aggregate expenditures in the economy contributed to a massive decline in income and to employment that was well below the average. In this situation, the economy might have reached a perfect balance, at a cost of high unemployment. Keynesian economists called on governments during times of economic crisis to pick up the slack by increasing government spending and/or cutting taxes.

Massive increases in deficit spending, new banking regulation, and boosting farm prices did start turning the U. S. economy around in 1933 as shown in the three graphs above, but it was a slow and painful process. The U. S. had not returned to 1929's GNP for over a decade and still had an unemployment rate of about 15% in 1940 ??? down from 25% in 1933. Inequality of wealth and income Marriner S. Eccles, who served as Franklin D. Roosevelt's Chairman of the Federal Reserve from November 1934 to February 1948,

detailed what he believed caused the Depression in his memoirs, *Beckoning Frontiers* (New York, Alfred A.

Knopf, 1951)[27]: As mass production has to be accompanied by mass consumption, mass consumption, in turn, implies a distribution of wealth — not of existing wealth, but of wealth as it is currently produced — to provide men with buying power equal to the amount of goods and services offered by the nation's economic machinery. [Emphasis in original.] Instead of achieving that kind of distribution, a giant suction pump had by 1929-30 drawn into a few hands an increasing portion of currently produced wealth. This served them as capital accumulations.

But by taking purchasing power out of the hands of mass consumers, the savers denied to themselves the kind of effective demand for their products that would justify a reinvestment of their capital accumulations in new plants. In consequence, as in a poker game where the chips were concentrated in fewer and fewer hands, the other fellows could stay in the game only by borrowing. When their credit ran out, the game stopped. That is what happened to us in the twenties. We sustained high levels of employment in that period with the aid of an exceptional expansion of debt outside of the banking system.

This debt was provided by the large growth of business savings as well as savings by individuals, particularly in the upper-income groups where taxes were relatively low. Private debt outside of the banking system increased about fifty per cent. This debt, which was at high interest rates, largely took the form of mortgage debt on housing, office, and hotel structures, consumer

installment debt, brokers' loans, and foreign debt. The stimulation to spend by debt-creation of this sort was short-lived and could not be counted on to sustain high levels of employment for long periods of time.

Had there been a better distribution of the current income from the national product — in other words, had there been less savings by business and the higher-income groups and more income in the lower groups — we should have had far greater stability in our economy. Had the six billion dollars, for instance, that were loaned by corporations and wealthy individuals for stock-market speculation been distributed to the public as lower prices or higher wages and with less profits to the corporations and the well-to-do, it would have prevented or greatly moderated the economic collapse that began at the end of 1929.

The time came when there were no more poker chips to be loaned on credit. Debtors thereupon were forced to curtail their consumption in an effort to create a margin that could be applied to the reduction of outstanding debts. This naturally reduced the demand for goods of all kinds and brought on what seemed to be overproduction, but was in reality underconsumption when judged in terms of the real world instead of the money world. This, in turn, brought about a fall in prices and employment. Unemployment further decreased the consumption of goods, which further increased unemployment, thus closing the circle in a continuing decline of prices.

Earnings began to disappear, requiring economies of all kinds in the wages, salaries, and time of those employed. And thus again the vicious circle of deflation was closed until one third of the entire working population was

unemployed, with our national income reduced by fifty per cent, and with the aggregate debt burden greater than ever before, not in dollars, but measured by current values and income that represented the ability to pay. Fixed charges, such as taxes, railroad and other utility rates, insurance and interest charges, clung close to the 1929 level and equired such a portion of the national income to meet them that the amount left for consumption of goods was not sufficient to support the population. This then, was my reading of what brought on the depression. The Great Depression ended The turning point in the depression was in 1933, as can be seen in the above Industrial Production graph. Some economists attribute the subsequent recovery to monetary expansion that began after the bank holiday a few days after Roosevelt was inaugrated on March 4, 1933 and devaluation of the U. S. dollar that was then tied to gold. [28] Literature

The U. S. Depression has been the subject of much writing, as the country has sought to re-evaluate an era that caused emotional as well as financial trauma to its people. Perhaps the most noteworthy and famous novel written on the subject is *The Grapes of Wrath*, published in 1939 and written by John Steinbeck, who was awarded both the Nobel Prize for literature and the Pulitzer Prize for the work. The novel focuses on a poor family of sharecroppers who are forced from their home as drought, economic hardship, and changes in the agricultural industry occur during the Great Depression.

Steinbeck's *Of Mice and Men* is another important novel about a journey during the Great Depression. The Great Depression is a novella written by Alon Bersharder about a sad, disgruntled temporary worker, making the title <https://assignbuster.com/free-market-economy-assignment/>

both a homage to the historical event and a pun. Additionally, Harper Lee's *To Kill a Mockingbird* is set during the Great Depression. Margaret Atwood's Booker prize-winning *The Blind Assassin* is likewise set in the Great Depression, centering on a privileged socialite's love affair with a Marxist revolutionary. Effects Australia Main article: Great Depression in Australia

Australia's extreme dependence on agricultural and industrial exports meant it was one of the hardest-hit countries in the Western world, amongst the likes of Canada and Germany. Falling export demand and commodity prices placed massive downward pressures on wages. Further, unemployment reached a record high of 29% in 1932,[29] with incidents of civil unrest becoming common. After 1932, an increase in wool and meat prices led to a gradual recovery. Canada [pic] [pic] Unemployed men march in Toronto, Ontario, Canada. Main article: Great Depression in Canada

Harshly impacted by both the global economic downturn and the Dust Bowl, Canadian industrial production had fallen to only 58% of the 1929 level by 1932, the second lowest level in the world after the United States, and well behind nations such as Britain, which saw it fall only to 83% of the 1929 level. Total national income fell to 56% of the 1929 level, again worse than any nation apart from the United States. Unemployment reached 27% at the depth of the Depression in 1933. [30] During the 1930s, Canada employed a highly restrictive immigration policy. [31] France Main article: Great Depression in France

The Depression began to affect France around 1931. France's relatively high degree of self-sufficiency meant the damage was considerably less than in

nations like Germany. However, hardship and unemployment were high enough to lead to rioting and the rise of the socialist Popular Front. Germany [pic] [pic] “ Diligent young man seeks work” Main article: Great Depression in Central Europe Germany’s Weimar Republic was hit hard by the depression, as American loans to help rebuild the German economy now stopped. [32] Unemployment soared, especially in larger cities, and the political system veered toward extremism.

The unemployment rate reached nearly 30% in 1932. [33] Repayment of the war reparations due by Germany were suspended in 1932 following the Lausanne Conference of 1932. By that time Germany had repaid 1/8th of the reparations. Hitler’s Nazi Party came to power in January 1933. [pic] [pic] Bonnie and Clyde were notorious bank robbers during what is sometimes referred to as the “ public enemy era” between 1931 and 1935. During the Depression bankers became so unpopular that bank robbers, such as John Dillinger, became folk heroes. [34] Japan The Great Depression did not strongly affect Japan.

The Japanese economy shrank by 8% during 1929??? 31. However, Japan’s Minister of Finance (MoF) Osachi Hamaguchi implemented the first version of Keynesian economic policies: first, by increasing deficit spending; and second, by devaluing the currency. The MoF believed that the deficit spending could easily be paid for when productivity improved. [citation needed] The devaluation of the currency had an immediate effect. Japanese textiles began to displace British textiles in export markets. The deficit spending, however proved to be most profound. The deficit spending went into the purchase of munitions for the armed forces.

By 1933, Japan was already out of the depression. By 1934 the MoF realized that the economy was in danger of overheating, and to avoid inflation, moved to reduce the deficit spending that went towards armaments and munitions. This resulted in a strong and swift negative reaction from nationalists, especially those in the Army, culminating in an assassination attempt on the MoF, leading to his eventual demise from poor health some months later. This had a chilling effect on all civilian bureaucrats in the Japanese government. From 1934, the military's dominance of the government continued to grow.

Instead of reducing deficit spending, the government introduced price controls and rationing schemes that reduced, but did not eliminate inflation, which would remain a problem until the end of World War II. The deficit spending had a transformative effect on Japan. Japan's industrial production doubled during the 1930s. Further, in 1929 the list of the largest firms in Japan was dominated by light industries, especially textile companies (many of Japan's automakers, like Toyota, have their roots in the textile industry). By 1940 light industry had been displaced by heavy industry as the largest firms inside the Japanese economy. 35] Latin America Main article: Great Depression in Latin America Because of high levels of United States investment in Latin American economies, they were severely damaged by the Depression. Within the region, Chile, Bolivia and Peru were particularly badly affected. Netherlands Main article: Great Depression in the Netherlands From roughly 1931 until 1937, the Netherlands suffered a deep and exceptionally long depression. This depression was partly caused by the

after-effects of the Stock Market Crash of 1929 in the United States, and partly by internal factors in the Netherlands.

Government policy, especially the very late dropping of the Gold Standard, played a role in prolonging the depression. The Great Depression in the Netherlands led to some political instability and riots, and can be linked to the rise of the Dutch national-socialist party NSB. The depression in the Netherlands eased off somewhat at the end of 1936, when the government finally dropped the Gold Standard, but real economic stability did not return until after World War II. [36] [pic] [pic] Buried machinery in a barn lot; South Dakota, May 1936.

The Dust Bowl on the Great Plains coincided with the Great Depression. [37] [pic] [pic] Entering Gulag (a leaf from Eufrosinia Kersnovskaya's notebook). During the Depression thousands of Americans emigrated to the Soviet Union. Many were arrested as potential "spies" during the Great Terror of 1937-38. [38] South Africa Main article: Great Depression in South Africa As world trade slumped, demand for South African agricultural and mineral exports fell drastically. The Carnegie Commission on Poor Whites had concluded in 1931 that nearly one-third of Afrikaners lived as paupers.

It is believed that the social discomfort caused by the depression was a contributing factor in the 1933 split between the "gesuiwerde" (purified) and "smelter" (fusionist) factions within the National Party and the National Party's subsequent fusion with the South African Party. [39] Soviet Union Main article: Economy of the Soviet Union#Economic development Having removed itself from the capitalist world system both by choice and as a

result of efforts of the capitalist powers to isolate it, the Great Depression had little effect on the Soviet Union.

A Soviet trade agency in New York advertised 6, 000 positions and received more than 100, 000 applications. [40] This was a period of industrial expansion for the USSR as it recovered from revolution and civil war, and its apparent immunity to the Great Depression seemed to validate the theory of Marxism and contributed to Socialist and Communist agitation in affected nations. This in turn increased fears of Communist revolution in the West, strengthening support for anti-Communists, both moderate and extreme.

Unlike the previous similar famine in Russia, information about the Soviet famine of 1932??? 1933 was suppressed by the Soviet authorities until perestroika. In 1933 workers' real earnings sank to about one-tenth of the 1926 level. [41] Common and political prisoners in labor camps were forced to do unpaid labor, and communists and Komsomol members were frequently " mobilized" for various construction projects. United Kingdom Main article: Great Depression in the United Kingdom The effects on the industrial areas of Britain were immediate and devastating, as demand for British products collapsed.

By the end of 1930 unemployment had more than doubled from 1 million to 2. 5 million (20% of the insured workforce), and exports had fallen in value by 50%. In 1933, 30% of Glaswegians were unemployed due to the severe decline in heavy industry. In some towns and cities in the north east, unemployment reached as high as 70% as ship production fell 90%. [42] About 200, 000 unemployed men were sent to the work camps, which

continued in operation until 1939. [43] [pic] [pic] Shacks, put up by the Bonus Army on the Anacostia flats, Washington, DC, burning after the battle with the 1, 000 soldiers accompanied by tanks and machine guns, 1932. [44]

United States Main article: Great Depression in the United States Early response Secretary of the Treasury Andrew Mellon advised President Hoover that shock treatment would be the best response: “ Liquidate labor, liquidate stocks, liquidate the farmers, liquidate real estate.... That will purge the rottenness out of the system. High costs of living and high living will come down. People will work harder, live a more moral life. Values will be adjusted, and enterprising people will pick up the wrecks from less competent people. “[45] Hoover rejected this advice, and started numerous programs, all of which failed to reverse the downturn. 46] Hoover launched a series of programs to increase farm prices, which failed, expanded federal spending in public works such as dams, and launched the Reconstruction Finance Corporation (RFC) which aided cities, banks and railroads, and continued as a major agency under the New Deal. To provide unemployment relief he set up the Emergency Relief Agency (ERA) that operated until 1935 as the Federal Emergency Relief Agency. Quarter by quarter the economy went downhill, as prices, profits and employment fell, leading to the political realignment in 1932 that brought to power the New Deal. [pic] [pic]

Great Depression: man lying down on pier, New York City docks, 1935. The New Deal Main article: New Deal Shortly after President Roosevelt was inaugurated in 1933, drought and erosion combined to cause the Dust Bowl, shifting hundreds of thousands of displaced persons off their farms in the midwest. From his inauguration onward, Roosevelt argued that restructuring <https://assignbuster.com/free-market-economy-assignment/>

of the economy would be needed to prevent another depression or avoid prolonging the current one. New Deal programs sought to stimulate demand and provide work and relief for the impoverished through increased government spending and institute financial reforms.

The Securities Act of 1933 comprehensively regulated the securities industry. This was followed by the Securities Exchange Act of 1934 which created the Securities and Exchange Commission. Though amended, key provisions of both Acts are still in force. Federal insurance of bank deposits was provided by the FDIC, and the Glass-Steagall Act. The institution of the National Recovery Administration (NRA) remains a controversial act to this day. The NRA made a number of sweeping changes to the American economy until it was deemed unconstitutional by the Supreme Court of the United States in 1935. [pic] [pic]

CCC workers constructing road, 1933. Over 3 million unemployed young men were taken out of the cities and placed into 2600+ work camps managed by the CCC. [47] Early changes by the Roosevelt administration included: ??? Instituting regulations to fight deflationary “cut-throat competition” through the NRA. ??? Setting minimum prices and wages, labor standards, and competitive conditions in all industries through the NRA. ??? Encouraging unions that would raise wages, to increase the purchasing power of the working class. ??? Cutting farm production to raise prices through the Agricultural Adjustment Act and its successors. Forcing businesses to work with government to set price codes through the NRA. [pic] [pic] WPA employed 2 to 3 million unemployed at unskilled labor. These reforms, together with several other relief and recovery measures are called the First <https://assignbuster.com/free-market-economy-assignment/>

New Deal. New regulations and attempts at economic stimulus through a new alphabet soup of agencies set up in 1933 and 1934 and previously extant agencies such as the Reconstruction Finance Corporation brought a sharp upswing of the economy, with GDP returning to the levels of the late 1920s.

By 1935, the “ Second New Deal” added Social Security (which did not start making large payouts until much later), a jobs program for the unemployed (the Works Progress Administration, WPA) and, through the National Labor Relations Board, a strong stimulus to the growth of labor unions.

Unemployment declined by over one-third in Roosevelt’s first term (from 25% to 14. 3%, 1933 to 1937). In Roosevelt’s second term, the economy went into a short, sharp recession in 1937-38. In 1929, federal expenditures constituted only 3% of the GDP.

The national debt as a proportion of GNP rose under Hoover from 20% to 40%. Roosevelt kept it at 40% until the war began, when it soared to 128%. After the Recession of 1937, conservatives were able to form a bipartisan conservative coalition to stop further expansion of the New Deal and, when unemployment dropped to 2% they abolished WPA, CCC and the PWA relief programs; Social Security, however, remained in place. Recession of 1937
Main article: Recession of 1937 In 1937 the American economy took an unexpected nosedive, lasting through most of 1938.

Production declined sharply, as did profits and employment. Unemployment jumped from 14. 3% in 1937 to 19. 0% in 1938. The Roosevelt administration reacted by launching a rhetorical campaign against monopoly power, which

was cast as the cause of the depression, and by appointing Thurman Arnold to act; Arnold's effectiveness ended once World War II began and corporate energies had to be directed to winning the war. The administration's other response to the 1937 deepening of the Great Depression had more tangible results.

Ignoring the pleas of the Treasury Department, Roosevelt embarked on an antidote to the depression, reluctantly abandoning his efforts to balance the budget and launching a \$5 billion spending program in the spring of 1938, an effort to increase mass purchasing power. Business-oriented observers explained the recession and recovery in very different terms from the Keynesians. They argued that the New Deal had been very hostile to business expansion in 1935??? 37, had encouraged massive strikes which had a negative impact on major industries such as automobiles, and had threatened massive antitrust legal attacks on big corporations.

All those threats diminished sharply after 1938. For example, the antitrust efforts fizzled out without major cases. The CIO and AFL unions started battling each other more than with the corporations, and tax policy became more favorable to long-term growth, according to this argument. On the other hand, according to economist Robert Higgs, when looking only at the supply of consumer goods, significant GDP growth resumed only in 1946 (Higgs does not estimate the value to consumers of collective, intangible goods like victory in war).

To some Keynesians, the war economy showed just how large the fiscal stimulus required to end the downturn of the Depression was, and it led, at

the time, to fears that as soon as America demobilized, it would return to Depression conditions, and industrial output would fall to pre-war levels. That Keynesian prediction that a new depression would start after the war failed to take into account massive savings and pent-up consumer demand, along with the ending of the restrictive wartime regulations in most consumer industries, and the cutting of high tax rates starting in 1946.

In any case, government spending and changing regulations (first tightening them, then loosening them) appear to have contributed to the recovery, as consumer and producer behavior changed. Keynesian models In the early 1930s, before John Maynard Keynes wrote *The General Theory*, he was advocating public works programs and deficits as a way to get the British economy out of the Depression. Although Keynes never mentions fiscal policy in *The General Theory*, and instead advocates the need to socialize investments, Keynes ushered in more of a theoretical revolution than a policy one.

His basic idea was simple: to keep people fully employed, governments have to run deficits when the economy is slowing because the private sector will not invest enough to increase production and reverse the recession. As the Depression wore on, Roosevelt tried public works, farm subsidies, and other devices to restart the economy, but never completely gave up trying to balance the budget. According to the Keynesians, he needed to spend much more money; they were unable to say how much more.

With fiscal policy, however, government could provide the needed Keynesian spending by decreasing taxes, increasing government spending, and

increasing individuals' incomes. As incomes increased, they would spend more. As they spent more, the multiplier effect would take over and expand the effect on the initial spending. The Keynesians did not estimate what the size of the multiplier was. Keynesian economists assumed poor people would spend new incomes; however, they saved much of the new money; that is, they paid back debts owed to landlords, grocers and family.

Keynesian ideas of the consumption function were upset in the 1950s by Milton Friedman and Franco Modigliani. [48] Neoclassical approach Recent work from a neoclassical perspective focuses on the decline in productivity that caused the initial decline in output and a prolonged recovery due to policies that affected the labor market. This work, collected by Kehoe and Prescott,[49] decomposes the economic decline into a decline in the labor force, capital stock, and the productivity with which these inputs are used. This study suggests that theories of the Great Depression have to explain an initial severe decline but rapid recovery in productivity, relatively little change in the capital stock, and a prolonged depression in the labor force. This analysis rejects theories that focus on the role of savings and posit a decline in the capital stock. Gold standard Every major currency left the gold standard during the Great Depression. Great Britain was the first to do so.

Facing speculative attacks on the pound and depleting gold reserves, in September 1931 the Bank of England ceased exchanging pound notes for gold and the pound was floated on foreign exchange markets. Great Britain, Japan, and the Scandinavian countries left the gold standard in 1931. Other countries, such as Italy and the United States, remained on the gold standard into 1932 or 1933, while a few countries in the so-called “ gold

bloc”, led by France and including Poland, Belgium and Switzerland, stayed on the standard until 1935-1936.

According to later analysis, the earliness with which a country left the gold standard reliably predicted its economic recovery. For example, Great Britain and Scandinavia, which left the gold standard in 1931, recovered much earlier than France and Belgium, which remained on gold much longer. Countries such as China, which had a silver standard, almost avoided the depression entirely. The connection between leaving the gold standard as a strong predictor of that country’s severity of its depression and the length of time of its recovery has been shown to be consistent for dozens of countries, including developing countries.

This partly explains why the experience and length of the depression differed between national economies. [50] Rearmament and recovery [pic] [pic] The Great Depression ended as nations increased their production of war materials at the start of World War II. A factory worker in 1942. Fort Worth, Texas. The massive rearmament policies to counter the threat from Nazi Germany helped stimulate the economies of Europe in 1937-39. By 1937, unemployment in Britain had fallen to 1.5 million. The mobilization of manpower following the outbreak of war in 1939 finally ended unemployment.

In the United States, the massive war spending doubled the GNP, either masking the effects of the Depression or essentially ending the Depression. Businessmen ignored the mounting national debt and heavy new taxes, redoubling their efforts for greater output to take advantage of generous

government contracts. Productivity soared: most people worked overtime and gave up leisure activities to make money after so many hard years.

People accepted rationing and price controls for the first time as a way of expressing their support for the war effort.

Cost-plus pricing in munitions contracts guaranteed businesses a profit no matter how many mediocre workers they employed or how inefficient the techniques they used. The demand was for a vast quantity of war supplies as soon as possible, regardless of cost. Businesses hired every person in sight, even driving sound trucks up and down city streets begging people to apply for jobs. New workers were needed to replace the 11 million working-age men serving in the military. These events magnified the role of the federal government in the national economy. In 1929, federal expenditures accounted for only 3% of GNP.

Between 1933 and 1939, federal expenditure tripled, and Roosevelt's critics charged that he was turning America into a socialist state. [51] However, spending on the New Deal was far smaller than on the war effort. Political consequences The crisis had many political consequences, among which was the abandonment of classic economic liberal approaches, which Roosevelt replaced in the United States with Keynesian policies. It was a main factor in the implementation of social democracy and planned economies in European countries after World War II. (see Marshall Plan).

Although Austrian economists had challenged Keynesianism since the 1920s, it was not until the 1970s, with the influence of Milton Friedman that the Keynesian approach was politically questioned, leading the way to

neoliberalism. [52] Facts and figures Effects of depression in the United States[53]: ??? 13 million people became unemployed. In 1932, 34 million people belonged to families with no regular full-time wage earner. [54] ??? Industrial production fell by nearly 45% between the years 1929 and 1932. ??? Homebuilding dropped by 80% between the years 1929 and 1932. In the 1920s, the banking system in the U. S. was about \$50 billion, which was about 50% of GDP. [55] ??? From the years 1929 to 1932, about 5, 000 banks went out of business. ??? By 1933, 11, 000 of the US' 25, 000 banks had failed. [56] ??? Between 1929 and 1933, U. S. GDP fell around 30%, the stock market lost almost 90% of its value. [57] ??? In 1929, the unemployment rate averaged 3%. [58] ??? In 1933, 25% of all workers and 37% of all nonfarm workers were unemployed. [59] ??? In Cleveland, Ohio, the unemployment rate was 60%; in Toledo, Ohio, 80%. [54] ??? One Soviet trading corporation in New York averaged 350 applications a day from Americans seeking jobs in the Soviet Union. [60] ??? Over one million families lost their farms between 1930 and 1934. [54] ??? Corporate profits had dropped from \$10 billion three years ago to \$1billion in 1932. [54] ??? Between 1929 and 1932 the income of the average American family was reduced by 40%. [61] ??? Nine million savings accounts had been wiped out between 1930 and 1933. [54] ??? 273, 000 families had been evicted from their homes in 1932. [54] ??? There were two million homeless people migrating around the country. [54] ??? One Arkansas man walked 900 miles looking for work. [54] ??? Over 60% of Americans were categorized as poor by the federal government in 1933. [54] ??? In the last prosperous year (1929), there were 279, 678 immigrants recorded, but in 1933 only 23, 068 came to the U. S. [62][63] ??? In the early 1930s, more people emigrated

from the United States than immigrated to it. [64] ??? New York social workers reported that 25% of all schoolchildren were malnourished. In the mining counties of West Virginia, Illinois, Kentucky, and Pennsylvania, the proportion of malnourished children was perhaps as high as 90%. [54] ??? Many people became ill with diseases such as tuberculosis (TB). [54] ??? The 1930 U. S. Census determined the U. S. population to be 122, 775, 046. About 40% of the population was under 20 years. [65] Other great depressions There have been other downturns called a “ Great Depression,” but none has been as worldwide for so long. British economic historians use the term “ Great depression” to describe British conditions in the late 19th century, especially in agriculture, 1873-1896, a period also referred to as the Long Depression. [66] Several Latin American countries had severe downturns in the 1980s.

Finnish economists refer to the Finnish economic decline around the breakup of the Soviet Union (1989-1994) as a great depression. Kehoe and Prescott define a great depression to be a period of diminished economic output with at least one year where output is 20% below the trend. By this definition Argentina, Brazil, Chile, and Mexico experienced great depressions in the 1980s, and Argentina experienced another in 1998-2002. This definition also includes the economic performance of New Zealand from 1974-1992 and Switzerland from 1973 to the present, although this designation for Switzerland has been controversial. [67][68] The economic crisis in the 1990s that struck former members of the Soviet Union was almost twice as intense as the Great Depression in the countries of Western Europe and the United States in the 1930s. [69][70] Average standards of living registered a

catastrophic fall in the early 1990s in many parts of the former Eastern Bloc – most notably, in post-Soviet states. [71] Even before Russia's financial crisis of 1998, Russia's GDP was half of what it had been in the early 1990s. [70] Some populations are still poorer today than they were in 1989 (e. g. Ukraine, Moldova, Serbia, Central Asia, Caucasus).

The collapse of the Soviet planned economy and the transition to market economy resulted in catastrophic declines in GDP of about 45% during the 1990-1996 period [72] and poverty in the region had increased more than tenfold. [73] The Asian Financial Crisis was a period of financial crisis that gripped much of Asia beginning in July 1997, and raised fears of a worldwide economic meltdown (financial contagion). The crisis started in Thailand with the financial collapse of the Thai baht caused by the decision of the Thai government to float the baht, cutting its peg to the USD, after exhaustive efforts to support it in the face of a severe financial overextension that was in part real estate driven. At the time, Thailand had acquired a burden of foreign debt that made the country effectively bankrupt even before the collapse of its currency. As the crisis spread, most of Southeast Asia and Japan saw slumping currencies, devalued stock markets and other asset prices, and a precipitous rise in private debt. [1] Though there has been general agreement on the existence of a crisis and its consequences, what is less clear is the causes of the crisis, as well as its scope and resolution.

Indonesia, South Korea and Thailand were the countries most affected by the crisis. Hong Kong, Malaysia, Laos and the Philippines were also hurt by the slump. The People's Republic of China, India, Taiwan, Singapore, Brunei and Vietnam were less affected, although all suffered from a loss of demand and

<https://assignbuster.com/free-market-economy-assignment/>

confidence throughout the region. Foreign debt-to-GDP ratios rose from 100% to 167% in the four large ASEAN economies in 1993-96, then shot up beyond 180% during the worst of the crisis.

In Korea, the ratios rose from 13-21% and then as high as 40%, while the other Northern NICs (Newly Industrialized Countries) fared much better. Only in Thailand and Korea did debt service-to-exports ratios rise. [2] Although most of the governments of Asia had seemingly sound fiscal policies, the International Monetary Fund (IMF) stepped in to initiate a \$40 billion program to stabilize the currencies of South Korea, Thailand, and Indonesia, economies particularly hard hit by the crisis. The efforts to stem a global economic crisis did little to stabilize the domestic situation in Indonesia, however.

After 30 years in power, President Suharto was forced to step down in May 1998 in the wake of widespread rioting that followed sharp price increases caused by a drastic devaluation of the rupiah. The effects of the crisis lingered through 1998. In the Philippines growth dropped to virtually zero in 1998. Only Singapore and Taiwan proved relatively insulated from the shock, but both suffered serious hits in passing, the former more so due to its size and geographical location between Malaysia and Indonesia. By 1999, however, analysts saw signs that the economies of Asia were beginning to recover. 3] The absence of toxic derivatives for subprime loans ??? a class of mortgage with a higher default risk ??? made everybody believe Romania will not be gripped by the crisis that was already unfolding in USA, last summer. However, as credit bubble was spreading toward the world's biggest financial centers, the confidence in financial institutions vanished,

<https://assignbuster.com/free-market-economy-assignment/>

the lenders not knowing the status of their competitors and thus fearing of a disastrous mass credit default. Since that moment, the financial deadlock started to spread like wildfire across all Romanian lenders.

Many of them were forced to abort lending procedures for companies; therefore the production and investment expenses were immediately affected. In this crisis of real economy, exporters are set to take the heaviest losses, as the demand and financing from European Union and United States, Romania's primary business partners, started to take a nosedive once the crisis spread. The most affected industry sectors The most affected fields are car industry, processing and textile industry, construction and wood sectors.

Companies announced massive layoff, reductions in short-term contracts, or temporary layoff, analysts estimating between 100, 000 and 400, 000 downsized workers. Chairman of National Association of Importers and Exporters (ANEIR), Mihai Ionescu said he expected between 100, 000 and 300, 000 axed workers in export production field while the chairman of National Council of Small and Medium-Sized Enterprises (CNIPMMR), Ovidiu Nicolaescu, said many companies in 30 counties had discharged nearly 50, 000 workers since early October.

The official statistics finds the first major signs of crisis in the last three months of this year. Thus, industrial output fell 0. 7% in October, compared to prior month, and 3% from a year earlier, due to 4. 6% decline in processing industry, which could not be wiped out by the advances in other sectors, according to data made public by INS. Furthermore, turnover of retail industry, excepting car and motorcycle sales slid 19% in October from

prior month, which reduced the annual growth pace to 8.6%. Industrial orders fell 3. % from prior month, due to declines in capital goods and current goods sector, INS informs. Imports shrunk its growth pace in October, down to 3.6% from a year ago, while exports climbed 13.3%, which reduced the trade deficit by 9% on a monthly basis. First casualty ??? real estate industry Pipeline of real estate deals has started to shrink this summer, given the uncertain international evolution of prices. Thus, in October, companies have put their deals on ice, as the international financial deadlock was doubled by the credit tightening regulations enforced by National Bank of Romania (BNR).

On the other hand, the slowdown of prices in construction and land acquisition was very likely after the major expenses in the past five years. Therefore, companies have put many deals on hold hoping for a recovery of prices, while others started to cut from their profit margins in an effort to conclude sale proceedings. In turn, it had a snowball effect in construction material segment, real estate agencies, furniture and interior decoration producers, and home appliances industry. Moreover, several companies were forced to abort their expansion plans, due to market deadlock.

Real estate analysts said the prices of old housing units had dropped by roughly 30% since January 1, 2008, and by 5-10% for new apartments, due to the international real estate downturn. The number of real estate deals fell by 20.8% in October 2008 from a year ago, down to 41.672 units, according to National Institute of Statistics (INS). It's happening now in America and is due here in the UK and Europe by summer, if the usual time lags apply. The

recession / depression / crash is on its way like an unstoppable tsunami. A tsunami is not a “tidal wave”.

Waves break and retreat when they hit shallow waters or the shore. A tsunami trundles on for miles inshore powered by tremendous forces out in the deep ocean. No power on earth can stop it until its energy is spent. Those who think we can stop a deep recession from happening by fiddling with interest rates or printing liquidity are looking at wave science not tsunamis. Now we can only watch and hope. The signs of families cutting back their spending are everywhere here in Britain. Apart from the super-rich, ordinary folk are drawing in their horns as if they never existed.

This mass retreat from the markets is beginning to have a cumulative effect which can only build to an inevitable crescendo. The banks are barely functioning, except as deposit-takers. When they get our money they hoard it like the early Ebenezer Scrooge ??? the kind of man who creates depressions or shows us how to avoid them, depending on your point of view. America is in deep trouble now, deserted even by the Sovereign Wealth Funds of the Orient, who just a few weeks ago seemed like saviours. Now they are pulling their cash out and retreating to the new economies of the East.

The “carry trade” to smaller Western economies, like Turkey, Iceland, Latvia, Estonia and others is falling apart, as will these countries in the coming months. Iceland may well be the first to crack, like some monstrous symptom of global warming tearing apart the ice sheets. Those that are in the eurozone are being held together only by the common currency, the

euro. But the fault-lines are beginning to show and it seems only a matter of time before the whole system snaps in a great twanging of over-stretched elastic.

Beethoven would not recognize the new European Symphony about to be played. An Ode to Joy it isn't. If we look at all this from a Scroogian perspective though, it's a kind of deep-cleanse that the world's febrile financial sectors need ??? and this is certainly a problem of their making. This tsunami began in the boardrooms of banks and retail lenders, not in the real economy where most of us work ??? although our greed doubtless helped. As America contracts, like a crab sensing danger, we can only await the storms to come. And they are the least of it. The unstoppable tsunami is the real enemy.