History of globalization great depression assignment

History

The consensus about the causes of the Great Depression remains today very little. Through empirical testing, Fickler and Parker (1994) considered the main mono-causal theories and showed that none of them could explain on their own the depth, the length and the consequences of the Great Depression. This international crisis was a complex phenomenon which resulted from the combination of different occurrences. We shall then consider each of these parameters and evaluate the extent to which they contributed to cause the Great Depression.

The Great Depression may firstly be considered as the result of structural Issues f the inter-war economy induced by World War l. Both political and economic structures were indeed deeply disrupted by the international conflict which tore the whole world up. Disruption of production during the war had permanent effects on trade patterns, trade politics and policy preferences. World War I may be an indirect cause of the Great Depression to the extent that it had profound consequences on international trade and investment flows.

First of all, “ war-induced diversion of production”(Horopito, 2004, 33) logically created a propitious context to the rise of protectionist measures. As a matter of fact, World War I had a deep Impact on the Inter-war real economy. The Inter-war period was marked by excess supply issues due to two mall mechanisms. Firstly, non- European primary production highly expanded owing to trade restrictions during the war. As the world economy returned progressively to freer trade after 1918, these new sources of supply induced an extra-offer and a downward pressure on prices.

This harder competition reawakened a real demand for protectionist policies. Secondly, European heavy-industry over-expanded in order to sustain the war effort. This over-expansion led to post-war excess supply and contributed to the development of protectionist forces. This protectionist tendency is confirmed by the increase of post-war tariffs across the major trading countries. Protectionist measures depend on the scarcity of productive factors; that is to say that governments protect sectors for which the main factor of production is scarce.

For example, Britain and France implemented high tariffs on capital-intensive manufacturing Industries, whereas the united States of America set protective tariffs on labor-Intensive manufactures. This shift In trade policy preferences may have averred the Great Depression. The rise of barriers and the increase of trade costs Down lea Inane to market Allegations, Down In terms AT volume AT trace Ana international capital flows (Haynes, Jacks and Recourse, 2009).

Market disintegration is undeniably harmful to economic growth and global competitiveness, owing to the fact that it implies a strong tightening of outlets and a growing uncertainty in the global economy. In this way, World War I deeply affected the structures of trade policy preferences and entailed a shift in international cooperation. These consequences described above may have contributed to cause the Great Depression. Nevertheless, it seems that the sass's global crisis resulted not only from this international context but a greater number of economic parameters.

Many scholars studied the Great Depression and its origins in the late 20th century. Certainly useful to understand current economic phenomena, the Great Depression arouses both academic and public interest. We shall then see which causes have been put forward and how convincing they each are. First of all, Anna Schwartz and Milton Friedman put forth the hypothesis of a monetary cause of the Great Depression. According to their analysis, movements in the real economy can be linked to the disruptions in the financial sector at that time.

The “ Great contraction” of the money supply (Friedman and Schwartz, 1963) may be an explanatory factor of the Great Depression to the extent that it worsened deflation. This hypothesis seems to be supported by empirical facts; money supply dropped by 35% in the United States, a great number of banks bankrupted, and prices decreased by approximately 33%. The banks failure induced a decrease of private wealth and a drop of money supply, which both contributed to exacerbate fellatio.

The monetary explanation of the Great Depression implies a failure of the Federal Reserve in its role of “ lender of last resort”. The simultaneity of deep deflation and continuous contraction in money supply reveals a systemic flaw. Schwartz and Friedman claim that the Federal Reserve had the ability to block deflation and therefore limit the damages of the crisis. As a matter of fact, the Federal Reserve did not lend to banks to avoid panics and did not implement a monetary expansion whereas the amount of gold allowed such a policy in the early sass’s.

The monetary lice of the United States may have in this way contributed to the strengthening of the Great Depression, but this hypothesis does not explain the reasons behind the behavior of the Federal Reserve and fails to explain the crisis on its own. The monetary hypothesis is not enough if considered as an isolated cause, especially since it cannot account for the unprecedented decline of output during the Great Depression (Brenan, 1983). In this perspective, financial disruptions other than shocks to the money supply also have an impact on the level of prices and level of output.

The main argument supporting this non-monetary explanation is debt deflation and financial markets inefficiency. Firstly, over-indebtedness and deflation in the inter-war period led to a downward deflationary spiral which was detrimental to the global economy. Deflation created indeed an increase of real debt burdens for many countries, and therefore drove them to insolvency. To this phenomenon is added a decrease of aggregate demand, which contributes to worsen deflation in a villous clear mechanism (Hasher, 1) secondly, ten Atlanta panics enlarger markets efficiency.

Financial disruptions of the recession period led to misinformation and inefficient allocation of funds from lenders to borrowers, which induced an increase in the cost of credit. As credit intermediation was getting more expensive, this non-monetary mechanism contributed to lower aggregate demand and therefore to make the recession even worse (Brenan, 1983). The combination of the monetary hypothesis and non-monetary financial disruptions seems to provide a satisfactory understanding of the

phenomenon that contributed to turn the initial recession into the Great Depression.

However, these approaches mainly account for the experience of the United States and do not entirely apprehend the international nature of the crisis. The main cause of the internationalization of the financial crisis remains in the major flaws induced by the gold standard, which provide a reasonable hypothesis to comprehend the Great Depression as an international economic cataclysm (Parker, 2002). Issues linked to the reconstruction of the gold standard during the inter-war period constitute the most important factor explaining the cause, the depth and the Engel of the Great Depression.

It is here essential to go back to the premises of the gold standard in order to understand how its mechanisms combined with contextual conditions led to the Great Depression. During the 1870-1914 period, the gold standard operated as a fixed exchange rate system, that is to say that each national currency was convertible in gold at a fixed exchange rate. The success of the whole system is based on free flows of gold between countries involved and requires free international capital flows.

The gold standard allows indeed an automatic adjustment f trade balances, known as the Home mechanism, which requires specific conditions to work efficiently. Countries experiencing a trade deficit lose gold to the benefit of their trading partners. In order to meet the gold standard rules, this phenomenon leads to a monetary contraction and to the rise of interest

rates. The trade balance can progressively go back to equilibrium through an increase of foreign capital influx in countries losing gold.

In addition to this mechanism, money contraction in these countries applies a downward pressure on prices. The improvement of imitativeness therefore contributes to re-establish the trade balance equilibrium. Such an adjustment mechanism requires a strong international commitment and a real cooperation within members in order guarantee smooth gold and capital flows on an international scale. Predictably enough, the gold standard was suspended during World War I but by the end of 1928, the United States, France, the United Kingdom and Germany had re- established the system of pegged exchange rates.

If it worked between 1870-1914, the inter-war period was a completely different time, and the re-establishment of the old standard was doomed to failure. We can firstly underline a difference in terms of wages flexibility. Before World War l, wages were relatively flexible, and an adjustment was possible in case of a bad shock on the gold standard system. The rise of democracy, socialism and trade unions during the inter-war period made this adjustment more Doolittle to Implement. I Nils macerate progress also reluctance political costs of neglecting the internal balance.

Because of electoral stakes, it became essential for governments to deal with unemployment rates, and internal affairs progressively overrode the gold standard necessity to maintain a sound external balance. As a result, the main conditions to ensure currency convertibility was often not observed, I. E. A domestic monetary policy based on long-term prices

stability and a commitment to fiscal soundness (Hamilton, 1988). In addition to this, an other characteristic of the inter-war period was against the gold standard success.

World War I left inter-allied debts and war reparations as a legacy, which favored non-financial disputes and damaged international cooperation. This contextual aspect partially explains the difficulty to get cooperation between central banks. The academic literature analyzing the structural flaws of the inter-war gold standard is very broad (Gingerers, 1986; Teeming, 1989; Brenan and James, 1991). Four main technical defects may however be considered as the cause of the gold standard collapse.

Firstly, the lack of coordination between gold-losing countries and gold-gaining countries produced asymmetries in their responses. As described above, a lost in gold reserves must be followed by a decrease of money supply in order to meet the gold standard requirements. This condition was not observed during the inter-war period, and governmental behavior led to deflation and deeper recession. Countries experiencing gold influx did not implement monetary expansion and therefore corrupted the equilibrating mechanism.

In the absence of this appropriate monetary policy, gold-gaining countries such as France and the United States kept extracting gold from the reserves of other countries and imposed even more deflation on gold-losing countries. In 1929, France and the United States indeed concentrated most of the world gold reserves and did not implement monetary expansion. Secondly, the system was widened so that national currency could be back not only by

gold reserves but also by reserves of a foreign convertible currency. This new parameter introduced instability and risk as a great pressure was put on some countries.

The United Kingdom, for instance, had to control its domestic money supply in accordance with its gold reserves, but also needed to closely follow the amount of currency possessed by foreign actors. Thirdly, the lack of power of central banks negatively impacted cooperation within members. For example, the Bank of France was not allowed to participate in open market operations, and the Federal Reserve failed to detect that a monetary expansion in the United States would benefit the whole world. Last but not least, each government fixed its own parity rate unilaterally when Joining the gold standard.

Some countries over-valued their currency and others under-valued it, creating a situation in which the return to the equilibrium was nearly impossible. The system was in that way doomed to fail since it was biased from the very first moment it was re-established. It is obvious that the gold standard was highly corrupted in the inter-war period and that its dysfunctions intrinsically made it unsustainable. Empirical research has proven that the recovery of national economies was highly dependent on leaving the gold standard, which adds value to this hypothesis.

By leaving the gold standard, governments were able to use monetary policy as an economic tool again. The obstinacy of political leaders to remain in this fixed exchange rate system explains ten Patten an ten rear Depression. The gold standard hypothesis appears to be a key explanation of the

mechanisms that led to the Great Depression in the sass's. As a matter of fact, it allows to comprehend not only the flaws of monetary policies within trading countries, but also he deflationary spiral which significantly dropped the level of international output.

Both the monetary hypothesis and the hypothesis of non-monetary financial disruptions seem to follow on from the major flaws of the gold standard. The latter performed as a policy constraint and prevented countries from using the monetary tool in order to revive their economy. This kind of mechanism is reminiscent of the situation encountered by the Euro-zone during the 2008 economic crisis. The requirements related to the common currency do not allow members to use monetary policies with the aim of adjusting their external balance.

Even though the 2008 crisis and the Great Depression are assuredly different, bearing in mind historical precedents allows a sharper understanding of current events, in particular when it comes to strategic choices and policy preferences of the main political leaders and policy-makers. Bibliography Brenan, B. S. (1983), ' Monetary effects of the financial crisis in the propagation of the Great Depression', American Economic Review, June. Brenan, B. S. And H. James (1991), ' The Gold Standard, Deflation, and Financial Crisis in the Great Depression: An International Comparison', in R. G.