



Great Depression II?

By Dr. G.W. Perritt

In early December, the National Bureau of Economic Research declared that the U.S. economy had been in a recession since December 2007. Furthermore, most economists believe that the current recession will continue through the first six months of 2009. If so, that would make this recession the longest since the Great Depression. In fact, a number of financial pundits have begun to use the "D" word to describe an unfolding economic scenario.

To be sure, the U.S. economy is in its worst shape since World War II. Consumer confidence and spending have plummeted, annual automobile sales are about 40 percent below their long-term average, the nation's unemployment rate is on the rise, bank lending is in a deep freeze, bank failures are rising, commodity prices are tumbling, and home prices, on average, are 30 percent below their peak reached in late 2006. However, it is quite presumptuous to dub this recession the Great Depression II.

Most of us were not alive or at least old enough to remember the misery heaped on the World in the 1930s. As the events of the 1920s and 1930s slip from memory, facts become replaced by myths. Blame for the economic debacle has been attributed to the 1929 stock market crash, enactment of the Smoot-Hawley Tariff Act, massive government intervention, and abandonment of the gold standard. The truth is that none of these events "caused" the Great Depression. It was a confluence of events during the decade of the 1920s that eventually resulted in an economic downdraft. In addition, a number of federal government missteps both deepened and prolonged what might have been a much shorter economic decline. The following time-line contains, what I believe, are the significant events leading up to and continuing through the economic meltdown of the 1930s.

The 1920s

- Federal government spending grows three times larger than tax collections during World War I. The government cuts spending in 1920 to balance the budget and a severe recession results.
- The value of farm land falls by nearly 40 percent between 1920 and 1929.
- Nearly 1,200 mergers occur during the decade. By 1929, nearly 6,000 companies disappear via merger and only 200 corporations control over half of all American industry.
- By 1929, the richest 1 percent own 40 percent of the nation's wealth. The bottom 93 percent experience a 4 percent drop in disposable income between 1923 and 1929.

- Individual productivity rises 43 percent during the decade.
- President Warren Harding dies in office in 1923, ending the most corrupt administration in American history.
- The stock market embarks on a spectacular bull run in 1924. Between May 1928 and September 1929, stock prices rise by 40 percent and average daily trading doubles to 5 million shares per day.

1929

- More than half of all Americans are living below a minimum subsistence level.
- Annual per capita income is \$750.
- The backlog of business inventories grows three times larger than the year before.
- Automobile sales decline by a third in nine months before the stock market crash.
- Construction spending is down more than \$2 billion since 1926.
- An economic recession begins in August, two months before the stock market crash. During this two month period, production declines at an annual rate of 20 percent, wholesale prices decline by 7.5 percent, and personal income shrinks 5 percent.
- The stock market meltdown begins on October 24 and the 29th is dubbed "Black Tuesday." Losses for the month total \$16 billion, an astronomical sum in those days.

1930

- By February, the Federal Reserve has cut the prime interest rate from 6 to 4 percent and expands the money supply. However, during the next 18 months, the Fed will add very little money to the shrinking economy.
- The Smoot-Hawley Tariff passes on June 17. With imports forming only 6 percent of the GNP, the 40 percent tariffs work out to an economy-wide effective tax increase of only 2.4 percent.
- The first bank panic occurs later in the year. A public run on banks results in a wave of bankruptcies. Bank failures and deposit losses are responsible for the contracting money supply.
- The GNP falls 9.4 percent from a year earlier and the unemployment rate climbs from 3.2 to 8.7 percent.

1931

- A second banking panic occurs in the spring.
- The GNP falls another 8.5 percent and the unemployment rate soars to 15.9 percent.

1932

- For 1932, GNP falls a record 13.4 percent and the unemployment rate balloons to 23.6 percent.
- Industrial stocks have now lost nearly 80 percent of their value since 1930.
- Nearly 10,000 banks have failed since 1929, representing 40 percent of the 1929 total.
- The nation's money supply has contracted 31 percent since 1929, GNP also declines 31 percent, and more than 13 million Americans have lost their jobs since 1929.
- Capital investment has tumbled from \$16.2 billion to a paltry \$330 million since 1929.
- Farm prices have fallen 53 percent since 1929.
- International trade has fallen by two thirds since 1929.
- The Fed makes its first major expansion of the money supply since February 1930.

- The top tax rate is raised from 25 to 63 percent.

1933

- Roosevelt is inaugurated.
- A third banking panic occurs in March. Roosevelt declares a Bank Holiday and closes financial institutions to stop a run on banks.
- Congress authorizes creation of the Agricultural Adjustment Administration, the Civilian Conservation Corps, the Farm Credit Administration, the Federal Deposit Insurance Corporation, the Federal Emergency Relief Administration, the National Recovery Administration, the Public Works Administration, and the Tennessee Valley Authority.
- U.S. goes off the gold standard.
- Roosevelt leads a redistribution of wealth from the rich to the poor, but is obsessed with a balanced budget. He later rejects Keynes' advice to begin heavy deficit spending.
- The free-fall of the GNP is significantly slowed; it dips only 2.1 percent this year and the unemployment rate rises slightly to 24.9 percent.

1934

- Congress authorizes the creation of the Securities and Exchange Commission and passes the Securities and Exchange Act.
- The economy turns around and a long road to recovery begins. GNP rises 7.7 percent and the unemployment rate falls to 21.7 percent.

1935

- Congress passes the Banking Act of 1935, the Emergency Relief Appropriation Act, the National Labor Relations Act, and the Social Security Act.

- Economic recovery continues. GNP grows another 8.1 percent and the unemployment rate falls to 20.1 percent.

1936

- The top tax rate is raised to 79 percent.
- Economic recovery continues. GNP grows a record 14.1 percent and the unemployment rate falls to 16.9 percent.

1937

- Economists attribute economic growth to heavy government spending. Roosevelt, however, fears an unbalanced budget and cuts spending for 1937. That summer, the nation plunges into another recession. Despite this, the yearly GNP rises 5.0 percent and the unemployment rate falls to 14.3 percent.

1938

- The year-long recession is accompanied by a 4.5 percent decline in GNP and an increase in the unemployment rate to 19.0 percent.

1939

- GNP rises 7.9 percent and the unemployment rate falls to 17.2 percent.
- World War II starts with Hitler's invasion of Poland.

There are similarities between the Great Depression and today's economic and financial meltdown. However, there are also marked differences. Could the current economic recession become the Great Depression II? While anything's possible, I believe the probability of a repeat of the 1930s is infinitesimal. The Administration, Congress, and the Fed are taking actions that are in a 180 degree direction of those taken in the Depression's early years. Furthermore, domestic efforts are being accompanied by global fiscal and monetary coordination that was nonexistent in the 1920s and 1930s.

I may be an optimist, but I am not a Pollyanna. I recognize that the U.S. economy is in big trouble. GDP will most likely plummet in the fourth quarter of 2008, and growth will likely be etched in red ink during the first six months of 2009. However, recent actions taken by both the Fed and the treasury have flooded the market with liquid assets and continued deficit spending should further prime the economic pump. As a result, look for an upturn in the economy by mid-2009. And like other economic slumps, look for the stock market to turn higher before this recession ends.

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