Learning From the Past: a Comparative Analysis of the Influences of the Great Depression on the Recent Financial Crisis

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Overview

- Great Depression
- Recent Financial Crisis
- Similarities
- Differences
- Learning from the Past
- The Role of Financial Regulation
- Impact of Economic Sectors
Great Depression

1925-1929 United States = 50% of world's industrial output.
Black Tuesday, October 29, 1929.
346 Banks failed first 6 months.
25% unemployment nation wide
The New Deal
$500 million in federal pay cuts
Recent Financial Crisis

- Baby Boomers
- Oil prices
- 37 million were living below the poverty line
- 7.2% unemployment
- Stimulus package
- Bailouts
  - GM, J.P. Morgan, Chrysler, etc.
Similarities

- Banks
- Stock Market
- GDP
- Unemployment
  - 25% comparative to 7.2% (population)
- Inflation (oil/gas)
Differences

- Global effect
  - Globalization
  - “what’s good for GM is good for America”
  - U.S. GDP in 2006 was $15 trillion, China was $3 trillion and India at $1.7 trillion
- Price differences on general services/goods
  - College, Houses, etc.
- Stimulus package vs. New Deal
Learning from the Past

- Third New Deal (stimulus package)
  - Changes from New Deal
- Bailout
  - Unemployment
  - GDP
- Ford Motor Company
Role of Financial Regulation

- Glass-Steagall Act
  - Banking Act of 1933, drew a line between investment banks and commercial banks
  - Repealed in 1999
- Basel I & Basel II
Role of Financial Regulation

- Basel I: let banks take on more risk in “less risky” transactions with a five category system.
  - Cash, took zero risk
  - Public risk, took varying risk (0-50% depending on rating)
  - Development bank debt took 20% risk
  - Residential mortgages took 50% risk
  - Private Sector took 100% risk
Basel I required banks to keep only 8% capital of the total Risk-Weighted Assets (RWA).

- RWA: adding up all the categories when multiplying their risk and debt.
- So you could have $100 million in RWA (basically debt) and to counter balance it you only were required to have $8 million.
Role of Financial Regulation

- Basel II:
  - Popped the mortgage bubble
  - Basel I is what inflated the mortgage bubble
  - Started surfacing in 2005
  - Gave “wake-up” call to many banks
Impact of Economic Sectors

- Real-Estate Sector
  - Fannie Mae & Freddie Mac, government-sponsored enterprises
- Financial Sector
  - Connections
- Auto Sector
  - Unemployment
Conclusion

- Glass-Steagall Act
  - Huge piece of regulation
- Financial Sector
  - Ties all sectors together
- Globalization
  - Technology
- Stimulus package
References

- About the great depression. (n.d.). Retrieved from http://www.english.illinois.edu/maps/depression/about.htm