HIGH UNEMPLOYMENT AND GROWTH SLOWDOWNS

Three cases:

1. The Great Depression, 1929-42

The Depression:

1929-33 real GDP fell 30 %, unemployment rose from 3.2 to 24.9; price level fell 24%

Why?

1. Stock market crash: wealth effect on consumption
2. Banking crisis: although monetary base increased 15%, broader money supply fell: M1 down 26%; some credit rationing
3. Expected deflation may have raised real interest rates
HARD QUESTION: WHY DID THE DEPRESSION LAST SO LONG?

1. Prices stopped falling after 1933, despite high unemployment
2. Large increases in the monetary base did not increase M1 or M2 very much
3. Interest rates near floor were not low enough: \( i = 0.5\% \) by 1933, \( 0.039\% \) by 1939

END OF GREAT DEPRESSION: WORLD WAR II

(Massive fiscal stimulus: deficit in 1942-3 was 30 percent of GDP)
EUROSCLEROSIS:

A very different story: no sudden rise in unemployment, just gradual increase over 20 years

Dip in unemployment at end of 80s - but inflation accelerated, suggesting natural rate of unemployment has steadily risen

Why increasing natural rate? Easy to explain *high* natural rate, in terms of social benefits, taxes, etc. Example of UK, where natural rate seems to have fallen, and contrast with US seem to support this story

The real European mystery: why were unemployment rates so low before 1973?
JAPAN: the future that didn’t work

Very high growth in 1950s, 60s (9 percent per year)

Slower after 1973, but still fast compared with other OECD countries - 3.5-4 percent per year

Huge “bubble” in stock and land prices in late 1980s, bursts in 1991

Growth slows to average 1.3 percent in 1992-7, est. -1.7 in 1998. probably negative next year too

Much dispute over size of “output gap”

Interest rates .25 percent, fiscal deficit projected at possibly 10 percent of GDP

Possible explanations:

1. Banking problems (hangover from bubble economy)
2. End of technological catchup/structural issues
3. Demography (aging population)