

# Drastic Times

*The Economist*

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# AEA meeting

- AEA: American Economic Association
- The prevailing mood at this year's event was one of despair, not hope

## 14 severe banking busts

- A study by Reinhart and Rogoff
- The Depression
- Recent “big five”: Spain in the late 1970s, Norway in 1987, Finland, Japan, and Sweden in the early 1990s
- Seven emerging-market crises
- The banking crises have been as common in rich economies as developing ones
- America **is** in financial crisis in 2009

## Stylized facts

- Downturns that follow a financial crisis are long and deep
- GDP per person falls by more than 9%
- Takes two years to reach bottom
- Unemployment increases by 7%, and reaches a peak almost after 5 years. Hence America's unemployment rate will reach 11–12% in the coming years
- House prices fall by 36% in about 5 years
- Equities lose more than half in less times

## Financial crisis and public finance

- Real government debt rises by an average of 86%
- It has little to do with the costs of bailing out banks. Rather it is because of a collapse in tax receipts, and a big increase in public spending
- Such a change in public finance **can not** prevent a deep and prolonged downturns

## Spend to save

- Most people agreed that a massive fiscal stimulus was needed to stop a deep recession
- There was not much consensus about what to do
- Robert Hall: A tax cut may not be effective
- Direct government purchase may have a impact but much of the benefit may be captured by producers

## However ...

- John Taylor argued, however, that there was scant evidence that fiscal policy does much to lift the economy
- America's 2008 tax rebates are a case in point
- Kenneth Rogoff: a terminally ill patient who is offered a risky treatment that may cure the disease but is sure to have nasty long-term side effects