



UNIVERSITY OF WASHINGTON
Economics Undergraduate Board
THE ECONOMIZER

VOLUME 29, NUMBER 01 DEPARTMENT OF ECONOMICS

AUTUMN 2019

Comparing the Wall Street Crashes of 1929 and 1987

VEDANT AGARWAL

October is sometimes described as the cruelest month for American stock markets. This is because two of the worst stock market crashes of the 20th Century happened in October of 1929 and October of 1987. Today, market historians, participants and observers, all claim that there is little in common between the two stock market crashes, so that makes way for some good comparisons. The Crash of 1987 eroded an enormous US\$ 500 Billion in wealth from the US stock market, whereas the Crash of 1929 eroded US\$ 14 Billion from the US stock market. One day losses were more in 1987 as the DJIA fell 22.6 percent on October 19, 1987, as compared to 12.8 percent on October 29, 1929. However, the crash of 1929 had a more sustained, negative, and long-term impact (possibly causing the Great Depression) on the US economy than the Crash of 1987.

One reason for this was the intervention of the

Federal Reserve in 1987 compared to its intervention in 1929. The Fed had inexplicably failed to curb the disaster in 1929. The Fed in August of 1929 raised the discount rate from 5 percent to 6 percent, a move which is said to have triggered the crash. This rate increase had unintended consequences, as, due to the international gold standard, the Fed's actions forced foreign central banks to raise their own interest rates. Tight monetary policies tipped economies around the world into recession. International commerce contracted, and the international economy slowed. According to Friedman and Schwartz, during this period of contraction, people were interested in holding more money than the FED was supplying. As a result of this, people started to hoard money, leading to less consumption. This reduced consumption caused a downturn in production and employment as prices were not flexible enough to immediately fall.

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Sahm's Rule

ARMAAN SINGH LAMBA

Ask anyone about what the biggest problem with tackling recessions is, and one of the most common answers would be to know when one happens. In the most recent recession of 2007-08, the official announcement wasn't made until one year after the recession had started (1). This poses a problem in that, by the time the Federal Reserve realizes that there is a recession, the recession is already in full swing. The main reason is that even if a recession is happening, it takes time to show up on indicators such as shrinking growth or increasing unemployment rate.

To tackle this issue, one of the newest indicators added to the Fed's arsenal is Sahm's rule. It states

that a recession might be coming if the three-month rolling average of the unemployment rate is more the 0.5 percentage points more than the twelve-month rolling average unemployment rate.

Now, with the recent discussion about the US heading into a recession because of the inverted yield curve of US bonds, what does Sahm's rule have to say about what is happening? Well, according to the Fed's official site, at the time of writing this article, the current three-month rolling average unemployment rate was 0.03 percentage points lower than the twelve-month rolling average (2). So, are we safe for now? According to this new indicator, yes!

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Economics Advising Office's Blog: <http://uwecon.wordpress.com>

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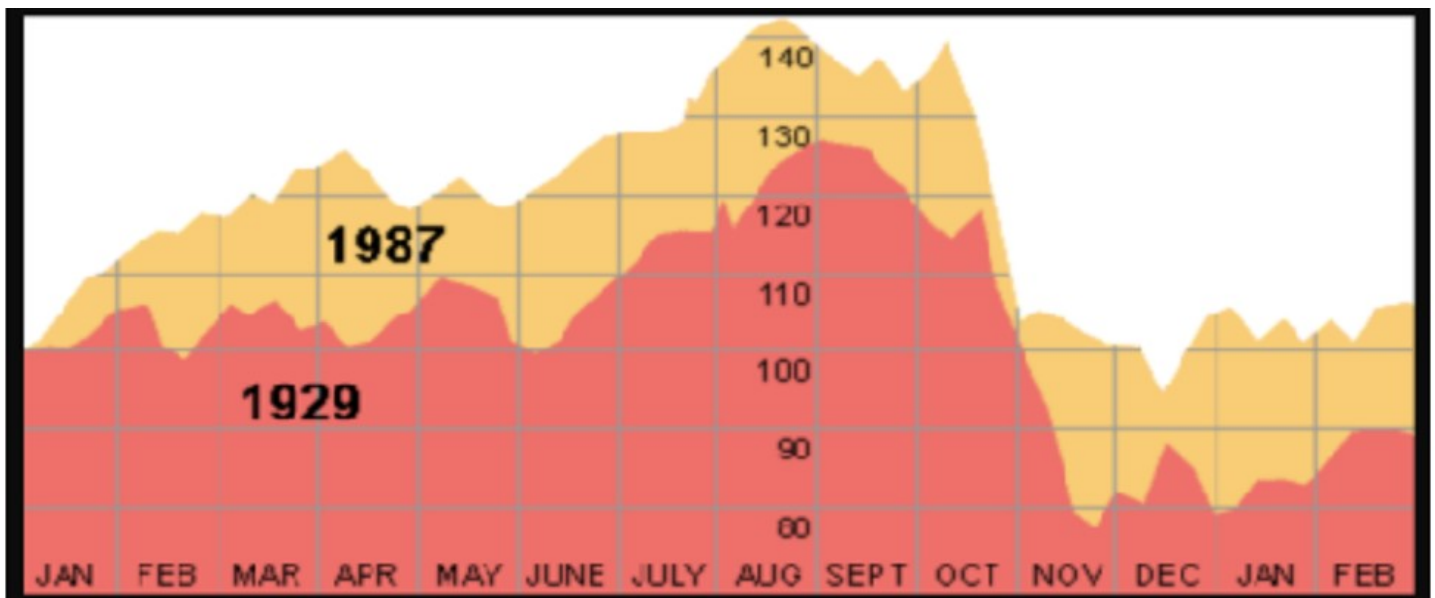
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Having learned its lesson, the scenario was somewhat different in 1987. Because of government regulations and trading limitations that had been put in place after 1929, the market recovered much more quickly and the long-term effect on the economy was modest in comparison to the worldwide depression of the 1930s. Broadly speaking, the recovery from the Crash of 1987 was sure and swift whereas that from the Crash of 1929 was long and painful. In 1987, after a turbulent eight days, the market appeared to have stabilized. By the end of the month, the Dow was some 15 percent above the Black Monday close. The blue-chip index spent the rest of the year trading between 1,776 (some 40 points above its Black Monday close) and 2,014 (some 200 points below its close the day before the crash) and ended 1987 with a small gain. The 1929 crash was actually a series of bad days -- Black Thursday, Black Tuesday - which caused the real panic, and the Monday in between when the Dow fell 13.5 percent, or 40.6 points, a record drop at that time. By the end in July 1932, the Dow was some 89.2 percent below its pre-crash peak of 381 on Sept. 3, 1929. It took another 22 years for the Dow to climb above the 300-level. Given these statistics, the two crashes widely differed in their severity and overall impact. The Crash of 1929 in a way turned out to be a blessing in disguise for investors in 1987. The dramatic loss of value that characterized both market crashes is illustrated in our graph, which index the weekly closing prices of the Dow Jones Industrial Average for 1929 and 1987. They use December 31 of

1928 and 1986 as the index point or base. One can thus say that the crash of 1929 represented an enormous loss of wealth both for individuals and companies. The crash of 1987 was sort of like the market losing its wallet for a couple of months.

References:

- 1) Eugene N. White, "The Stock Market Boom and Crash of 1929 Revisited" *The Journal of Economic Perspectives* Spring 1990
- 2) Ben S. Bernanke "The Federal Reserve and the Financial Crisis"
- 3) Harold James "1929: The New York Stock Market Crash" *Representations*, Vol. 110, No. 1 (Spring 2010), pp. 129-14, University of California Press.



Continued: Sahm's Rule:

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But is this the case, can we relax for now? Well, I have some issues with this indicator. The first thing that concerns me is that this rule doesn't account for the seasonality of unemployment. Currently, businesses are preparing for the holiday season, hiring seasonal employees, thus lowering the unemployment rate. Hence, even though we may be well into a recession, the data would not show it because of seasonal employment. Second, the rule assumes that recessions will start quickly, with the three-month average of the unemployment rate being drastically higher than last year's unemployment rate. It ignores the fact that a recession could loom for years and slowly worsen to a point where we recognize it. And at last, the Federal Reserve did drop the lending rate, which clearly shows that many economists believe that the economy is not performing as well as it should, which is contrary to what this indicator shows us right now.

Now, I don't want to just point out the negatives and leave it there, as this method does provide us

with another way of recognizing a downturn, which is always appreciated. However, even though we are now armed with more data and techniques than ever to recognize and deal with economic downturns, the best way to tackle recessions, in my opinion, is to have smart policies that include unemployment benefits for the workers, which automatically kick in, lowering the effect of recessions from the ground up and providing more stability to the economy.

References:

- 1) <https://www.nber.org/cycles.html>
- 2) <https://news.research.stlouisfed.org/2019/10/fred-adds-sahm-rule-recession-indicators/>

Antitrust Policy and the Virtue of Economics

RENIC SLOAN

For the past fifty years, antitrust law has been a niche field populated by a small number of economists and lawyers. But, with the rise of Big Tech companies such as Facebook, Google, and Apple, antitrust has been thrust into the political spotlight. Antitrust law, codified in 1890 by the Sherman Act, promotes competition for the end goal of maximizing consumer welfare. It explicitly outlaws unreasonable agreements to restrain trade and actions that improperly maintain market power.

For the first 70 years of antitrust law, enforcement was focused on the structure of the market. "Big is bad" and "more firms, more competition" were the dominant mantras of the day. However, economists and lawyers from the University of Chicago applied microeconomic principles to individual cases to show that the prevailing wisdom to target big companies was harming consumers in the economy. They argued that current policy resulted in the protection of inefficient competitors, higher prices, and lower rates of innovation. These factors all conspired to reduce consumer welfare.

Since the 1970s, when these "Chicago" ideas were developed, advances in game theory have refined the community's consensus on certain anticompetitive practices. For example, the traditional Chicago School held that predatory pricing is irrational. The uncertainty of being able to raise prices to supra-competitive levels in the future made sacrificing profit in the present a nonstarter. This theory emphasized that market entry will occur if firms have the expectation of high margins.

Advances in game theoretic models suggested that predatory pricing actually could be rational for two reasons. First, barriers to entry make entry of new firms more difficult than previously thought. Second, when monopolist firms engage in aggressive predatory pricing, they signal to potential competitors that they will be undercut if they enter the market. The value of signaling aggressive competition makes the temporary loss of profit negligible to dominant firms.

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The development of predatory pricing models highlights a virtue of the Chicago school of antitrust. Chicago scholars emphasized using economic models to guide action rather than political or social goals, whatever those may be. Grounding antitrust in economics produced greater certainty for firms and greater wealth for consumers. However, populist antitrust is once again taking hold in political circles.

Many prominent politicians advocate breaking up “Big Tech” and they suggest antitrust law is the proper mechanism to achieve their goals. They are supported by “New-Brandeisian” antitrust scholars who also argue that adopting the consumer welfare standard has led enforcement agencies to be too permissive of firm behaviors. The name honors Louis D. Brandeis, a Supreme Court Justice from 1916-1939 who believed that power, both political and economic, should be as decentralized as possible.

Although there are many valid concerns regarding Big Tech’s influence on our society, economics-based antitrust policy should not be subservient to political ends. Whereas policy grounded in economics can evolve, as predatory pricing models have, political (or populist) antitrust will foster uncertainty in business and cronyism in enforcement. When firms can lobby regulators to investigate their competitors, money will flow from R&D to K-street, reducing the welfare of us all.

UPCOMING EVENTS:

Math/Stats Review: In early Winter quarter the EUB will be hosting a Math and Statistics Review Seminar to help students brush up on the math used in ECON 200/201, as well as ECON 300/301.

Winter Quarter Events: In Winter Quarter the EUB will be hosting various events such as a career panel, an Econ major social, and the quarterly Paul Heyne lecture. Keep an eye out for these events in your email.

Economics Tutoring: The EUB offers free tutoring every weekday at various times every quarter! Check the schedule on the EUB website to see tutoring times. If you need help with an upper level class, however, make sure you check the website to see which tutor can help.

Economizer Submissions: The Economizer will be seeking guest writers for our Winter Quarter issue. Interested writers should check their emails from the department in early Winter quarter for submission instructions.

The Economizer is a quarterly newsletter published by the Economics Undergraduate Board.

The articles herein do not necessarily reflect the views of the department or its faculty.

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