



Critical analysis of the Great Depression and its Relevance to the Current Economic Crisis

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Abstract:

The Great Depression is considered the most important economic event in world history. During this period, mostly from 1929 to 1945, there was widespread mismanagement of economic tools across economies worldwide. High levels of unemployment, massive collapses, and sharp output contractions were characteristic of this event. This paper aims to understand the main causes of the Great Depression and the links between it and current economic events, such as the Great Recession of 2008 and the pandemic shock of 2019. However, the authors also investigate the main reasons for this event and any possible links to current economic mismanagement in decision-making.

Keywords: *Great Depression, Crisis, Recession, Gross Domestic Product (GDP), Fiscal Policy, and Unemployment.*

Introduction:

The Great Depression remains the most definitive systemic failure in the history of modern industrial capitalism, a decade of paralysis that fundamentally reshaped the global economic, political, and social landscape. Originating in the United States in 1929, the crisis crossed national boundaries to become a worldwide tragedy, marked by a staggering collapse in output, unprecedented mass unemployment, and the total disintegration of international trade.

In the specialized parlance of macroeconomic history, this period is viewed not merely as a severe recession but as a "turning point" that compelled the abandonment of classical economic orthodoxy and paved the way for the rise of the interventionist welfare state. The duration and severity of the downturn varied significantly across geographic regions, yet

its common features—banking panics, deflationary spirals, and sovereign debt defaults—left an indelible mark on the 20th century, ultimately contributing to the onset of the Second World War and the emergence of a new international economic order.

Objectives of the Research:

- To understand the real reasons for the Great Depression and its relevance.
- To understand the Great Depression and the major factors that prompted it
- To examine the mechanisms adopted by various countries to mitigate the harm caused by this Depression
- To evaluate the Great Depression and its relevance to the current financial landscape.
- To Analysis: 1929, 2008, and the Pandemic Shock

Problem of the Research:

- What happened during the Great Depression, and how has the world responded to it nearly a century later?
- Have equivalent economic collapses occurred anywhere in the world, and are they comparable to the Depression of 1930?
- How was the Great Depression related to the current financial crisis?
- How are the financial crises of 1929, 2008, and the Pandemic Shock related to the Great Depression?

Hypothesis of the Research:

1. Although it occurred almost a century ago, the Great Depression still has a profound impact on the world's economic activities today.
2. It is still considered one of the greatest economic downturns in human history.
3. The Great Depression remains deeply ingrained in the global economy, and current economic downturns are comparable to it.
4. The Great Depression has some indirect relationships to 1929, 2008, and the Pandemic Shock.

Research Methodology:

Mainly, this research is quantitative, also called a quantitative study; so, it is based on the secondary method of data collection, also called the non-doctoral method of data collection, and it mainly uses secondary sources. On the other hand, according to the nature of the study, the research design would be descriptive and diagnostic, whereas the deductive approach would be useful to carry out the research.

Primarily, the category of secondary sources includes government reports and documents, such as Indian government reports, archival papers, references from various ministries and their annual reports, foreign policy

annual reports from around the world, and research reports from the World Bank, the IMF, other international organizations, and expert case studies.

On the other hand, the second category of secondary sources is mostly library-based, including books, articles, newspapers, extracts, magazines, journals, seminar papers, and photographs, i.e., sources that would be used to study the particular problem.

The Conceptual Framework of Economic Depression:

In rigorous economic analysis, a depression is distinguished from a standard recession by its duration and the depth of its impact on an economy's structural foundations. While a recession is typically defined as two consecutive quarters of declining gross domestic product (GDP), a depression is a protracted downturn lasting several years, resulting in a permanent loss of economic potential.

The Great Depression exhibited seven core characteristics that serve as a blueprint for identifying systemic economic collapse:

1. **Massive Unemployment:** Peak rates reached 25% in the U.S. and even higher in some industrialized regions of Europe.
2. **Credit Contraction:** A catastrophic drop in available credit as banks collapsed and surviving institutions tightened lending standards.
3. **Output Collapse:** Industrial production fell by nearly 47% in the U.S. and 41% in Germany.
4. **Widespread Insolvency:** A surge in business and individual bankruptcies.
5. **Sovereign Defaults: Nations were unable to service their debts, leading to a breakdown in international finance.**

6. **Trade Disintegration:** The volume of international trade fell by roughly two-thirds from 1929 to 1934.

7. **Currency Volatility:** Extreme volatility in currency values and the eventual abandonment of the gold standard.

The severity of the 1929 crisis was unprecedented. Between 1929 and 1933, manufacturing output in the United States fell by one-third, and wholesale prices dropped by roughly 32 percent. This deflationary pressure made repaying existing debts exponentially more difficult, as the real value of the dollar rose while nominal incomes plummeted.

The American Epicentre and the System of Contraction:

The Great Depression originated primarily in the United States, which, following the First World War, had emerged as the world's leading industrial and financial power. The decline began with a sharp drop in aggregate demand, driven by a collapse in domestic investment. During the "Roaring Twenties," an investment boom had expanded the capital stock; however, as production capacity reached its limit and consumption began to lag, firms found themselves with excessive inventories and little incentive for new capital formation.

The catastrophic stock market crash of October 1929, highlighted by "Black Thursday," served as the immediate trigger for a total breakdown in business confidence. On October 24, 1929, a record 12.9 million shares were traded as investors rushed to liquidate holdings. The subsequent loss of wealth—with the Dow Jones Industrial Average falling from a peak of 381 to a low of 41 by 1932—shook the psychological foundations of the American consumer.

The Monetary Policy Failure:

While the crash was a psychological blow, modern scholarship emphasizes that the

subsequent failure of the banking system and misguided monetary policy responses converted a severe downturn into a decade-long catastrophe. Between 1930 and 1933, roughly 9,000 American banks failed, wiping out the life savings of millions and resulting in a 25% contraction in the quantity of money.

The Federal Reserve, adhering to the flawed "Burgess-Riefler doctrine," treated low nominal interest rates as a sign of monetary ease and failed to act as the lender of last resort. This passivity caused the money supply to plummet, effectively starving the economy of liquidity.

Theoretical Warfare: The Battle for Macroeconomic Policy:

The failure of classical models to address the Depression led to a paradigm shift in macroeconomic theory, primarily centred on the work of John Maynard Keynes and his intellectual rival, Friedrich Hayek.

The Keynesian Revolution:

In 1936, Keynes published *The General Theory of Employment, Interest and Money*, arguing that the Depression stemmed from a chronic deficiency of aggregate demand. He rejected the classical view that markets automatically return to full employment through wage and price adjustments, noting that in a "liquidity trap," interest rates could not fall low enough to stimulate investment. Keynes advocated active government intervention, suggesting that the state use its borrowing and spending power to stimulate the economy through fiscal stimulus—a concept that became the blueprint for modern fiscal policy.

The Austrian Critique:

In contrast, Friedrich Hayek and the Austrian School held that the Depression stemmed from "malinvestment" caused by the Federal Reserve's easy-money policies in the 1920s. Hayek argued that the slump was a necessary, if painful, process of eliminating

unsustainable investments financed by credit creation rather than genuine savings. He warned that government "pumping" of money would merely prolong the distress and distort market signals. Unlike Keynes, who focused on aggregates, Hayek emphasized individual choices and the organic nature of market processes.

The Monetarist Explanation:

Decades later, Milton Friedman and Anna Schwartz argued in *A Monetary History of the United States* that the Depression was primarily a "Great Contraction" caused by the Fed's failure to prevent the collapse of the money supply. They contended that the crisis was not an inherent failure of capitalism but a failure of government management of the money stock.

Irving Fisher and the Theory of Debt-Deflation:

One of the most profound theoretical insights to emerge from the crisis was Irving Fisher's Debt-Deflation theory, published in 1933. Fisher argued that the Depression was not a standard business-cycle fluctuation but a "vicious spiral" triggered by over-indebtedness and fuelled by deflation.

Fisher's formulation identified nine specific links in this chain of consequences:

1. **Liquidation:** Debtors engage in distress selling to pay off loans.
2. **Money Contraction:** Paying off bank loans reduces the money supply and slows the velocity of circulation.
3. **Falling Prices:** Contraction causes the price level to drop (the dollar "swells").
4. **Loss of Net Worth:** Business values plummet, leading to bankruptcies.
5. **Profit Collapse:** Firms operate at a loss.
6. **Production Cuts:** Output, trade, and employment are reduced.
7. **Pessimism:** Losses lead to a total loss of confidence.

8. **Hoarding:** Fear causes people to hoard cash, further slowing circulation.

9. **Interest Disturbances:** Nominal interest rates fall, but real (commodity) interest rates rise sharply.

Fisher famously noted the paradox that "the more the debtors pay, the more they owe," because the falling price level increases the real burden of remaining debt faster than it can be paid down.

The Golden Fetter: The International Monetary Order:

The Great Depression was transmitted globally through the rigidities of the international gold standard. By 1929, roughly 30 nations had returned to gold, a system of fixed exchange rates that required central banks to maintain a specific ratio of gold reserves.

When the U.S. Federal Reserve raised interest rates in late 1928 to curb speculation, it forced other gold-standard nations to follow suit to protect their reserves. This "golden fetter" prevented nations from using expansionary monetary policy to combat the downturn. Research indicates that countries that abandoned the gold standard early—such as the United Kingdom in 1931—recovered significantly faster than those that remained on the system, such as France.

Regional Impact and Recovery: A Global Survey

1. The United Kingdom: The 1931 Turning Point:

By 1930, the UK's unemployment had doubled to 2.5 million as its heavy industries (coal, steel, textiles) lost competitiveness. The turning point came in September 1931, when the UK was forced off the gold standard. This allowed a 25% devaluation of the pound, making

British exports more competitive and enabling a "cheap money" policy of low interest rates. This shift is estimated to have reduced the aggregate

2. Germany: Austerity and Radicalization:

Germany experienced a deep slump comparable to that in the U.S., with industrial output falling by over 40% and unemployment reaching 6 million by early 1933. Chancellor Heinrich Brüning's "deflationary" policies—including a 10% pay cut for civil servants and reductions in unemployment benefits—deepened the slump and undermined faith in democracy. This environment paved the way for the Nazi Party, which won 18.3% of the vote in 1930. Recovery under the Nazi regime was driven by massive state-led job creation and rearmament, achieving full employment by 1936, though at the cost of "crowding out" private demand.

3. Canada and the Prairie Crisis:

Canada's dependence on raw materials and farm exports made it one of the hardest-hit nations, with Gross National Income dropping 40%. The Prairie provinces suffered from both a price collapse and a crippling drought (the "Dirty Thirties"). Saskatchewan's income plummeted 90% over two years, forcing 66% of the rural population onto relief. Prime Minister R.B.

unemployment rate by 1.5 percentage points through the export channel alone.

Bennett initially pursued laissez-faire policies before attempting an interventionist "New Deal" late in his term, though many of these measures faced constitutional challenges.

4. India: The Gold Drain:

India, though less integrated into the global industrial core, suffered severely because of its reliance on agricultural exports. Between 1928 and 1934, India's trade nearly halved, and wheat prices fell by 50%. The British Raj's refusal to reduce land revenue demands, coupled with a high rupee-sterling exchange rate, forced peasants to sell their gold to survive. This "gold drain" saw 7.7 million ounces of gold exported in 1931-32 alone to revitalize the British economy, an extraction of wealth that intensified anti-colonial sentiments.

The New Deal: An Experiment in Social Welfare:

Franklin D. Roosevelt's New Deal fundamentally altered the relationship between the American citizen and the state, ushering in the modern welfare state.

Program	Function	Quantitative Impact
WPA – Works Progress Administration	Public Works Construction	State income multipliers of around one; reduced crime and mortality.
CCC – Civilian Conservation Corps	Youth Job Training	Improved height, health, and added one year to life expectancy.
HOLC – The Home Owners' Loan Corporation	Mortgage Refinancing	Staved off drops in housing prices; low ex-post cost to taxpayers.
SSA – Social Security Act	Social Security	Established a national safety net for the elderly.
RFC – The Reconstruction Finance Corporation	Corporate/Bank Loans	Limited impact on general lending; most effective when taking equity stakes.

While the New Deal restored confidence, historians generally agree that full employment was not achieved until the onset of World War II in 1939.

Comparative Analysis: 1929, 2008, and the Pandemic Shock:

A critical examination of the Great Depression reveals striking parallels and meaningful differences with more recent economic crises.

The COVID-19 Recession (2020):

The pandemic shock was the deepest since the 1930s, with U.S. GDP falling at an annualized rate of 32.9% in the second quarter of 2020. However, the policy response was unprecedented; the \$2 trillion CARES Act provided relief equal to 10% of GDP, far exceeding the scale of the initial New Deal programs. Unlike the gradual rise in unemployment in the 1930s, the 2020 spike to nearly 15% was instantaneous but was met with a robust recovery due to massive fiscal transfers.

The 2025 Perspective and Future Outlook:

As of early 2025, the global economy has entered a new era of "epistemic uncertainty." The U.S. effective tariff rate has surged past levels seen during the Great Depression, prompting counter-responses from major trading partners. International organizations warn that sustained protectionism and de-globalization could significantly slow global growth.

Furthermore, the post-pandemic recovery masks a sharp divergence; while high-income economies are richer per capita than in 2019, one-quarter of emerging-market and developing economies remain below pre-pandemic income levels. The "gold standard" may be gone, but the "hegemonic effects" of major economies mean that domestic policy shifts—including tariffs and

The Great Recession (2008):

The 2008 crisis began with downward shocks to global industrial production and trade as large as those in 1929. However, it was prevented from becoming a full depression because policymakers—led by Fed Chairman Ben Bernanke, a scholar of the 1930s—ensured the Fed acted as the lender of last resort. While GDP declined by 31% from 1929 to 33, it fell by less than 4% in 2008-09.

interest-rate adjustments—still have profound global effects.

Conclusion: Avoiding the Next Great Descent:

We learned during the Great Depression that the economy is a complex system of social trust rather than a self-correcting mechanism. We have instruments in 2026 that they did not have in 1929: worldwide statements, efficient central banking, and real-time data.

But the fundamental risks are still the same:

- **Excessive Debt**
- **Income Inequality**
- **Social Division**

The "New Deal" of the twenty-first century will likely involve a balance between AI's efficiency and people's vital need for economic security and stability. So, at last, the world's economies have to maintain such a checks-and-balances system to control various economic activities throughout the world.

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